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COLLECTION OF STATE SALES AND USE TAXES BY OUT-OF-STATE VENDORS

HEARING

BEFORE THE

SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 639 and S. 1099

NOVEMBER 6, 1987

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COLLECTION OF STATE SALES AND USE TAXES BY OUT-OF-STATE VENDORS

FRIDAY, NOVEMBER 6, 1987

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:39 a.m. in Room SD-215, Dirksen Senate Office Building, the Honorable Max Baucus (chairman of the subcommittee) presiding.

Present: Senators Baucus and Mitchell.

Also present: Senator Burdick.

[The press release announcing the hearing, the prepared written statement of Senator Mitchell, and a description of S. 639 and S. 1099 follow:]

[Press Release No. H-67, October 21, 1987]

FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT TO HOLD HEARING ON THE COLLECTION OF STATE SALES AND USE TAXES BY OUT-OF-STATE VENDORS

WASHINGTON, D.C.—Senator Max Baucus (D., Montana), Chairman of the Senate Finance Subcommittee on Taxation and Debt Management, announced Wednesday that the Subcommittee will hold a hearing on S. 639 and S. 1099, bills introduced to empower states to require out-of-state vendors to collect state sales and use taxes.

The hearing is scheduled for Friday, November 6, 1987 at 9:30 a.m., in Room SD-215 of the Dirksen Senate Office Building.

"A state or local government may impose taxes on sales or uses of property within its jurisdiction," Baucus said. "The question to be addressed by this hearing is what action, if any, the Congress should take to allow states to collect those taxes more effectively when sales are made by out-of-state vendors."

STATEMENT OF SENATOR GEORGE J. MITCHELL
SENATE COMMITTEE ON FINANCE
STATE TAXATION OF INTERSTATE SALES
NOVEMBER 6, 1987

It was almost two years ago that this Subcommittee last held hearings on legislation to empower states to collect sales and use taxes on out-of-state mail order firms.

Little has changed since then. Both sides in this debate present compelling arguments why Congress should act one way or the other.

State and local governments are understandably eager to expand the reach of their sales tax laws to increase collections. The pressures for this type of legislation have increased in recent years as the fiscal burdens of state and local governments have increased in the wake of deficit reduction legislation enacted at the federal level.

When ever the federal government cuts back on essential spending programs that must be maintained at the local level, or imposes new standards on state and local government programs, or enacts new taxes which erode the taxing power of the states, the federal government is directly responsible for the fiscal fortunes of state and local governments.

It is, therefore, understandable that state and local governments are intensely interested in this legislation where the federal government can, theoretically at least, ensure a greater flow of tax revenue to the states at no cost to the federal government.

But, as we all know, the taxing power of states is not unlimited and there are serious questions whether it is either fair or constitutionally permissible for state governments to collect taxes from businesses which have little or no relationship with the state.

The Supreme Court has ruled on the Constitutionality of this issue. And, although it has clearly stated that the states do not have the authority to collect sales taxes on out-of-state businesses, it is less clear whether Congress can grant states such powers under the Commerce Clause. That is a close question which this Subcommittee would not presume to answer.

Constitional considerations aside, we must decide whether it is appropriate for the taxing power of states to reach to businesses whose only connection to the state is through the mail.

I believe opponents of this legislation present compelling arguments why it would not be appropriate for the taxing power of state and local governments to reach outside their jurisdictions to businesses located in other states. There are more than 6,000 state and local jurisdictions in this country which impose sales and use taxes. It would be an intolerable burden on mail order businesses to determine the tax rate that applies to each sale throughout the nation, whether a particular item is exempt under local laws, or who the tax should be remitted to.

Governments impose taxes as a means of financing government services. It is, therefore, appropriate for citizens of a

state through their local retail establishments to pay taxes to finance government operations. But we must inquire whether it is also appropriate for out-of-state businesses, which derive no benefit from state services, to bear such tax burdens.

In theory we know that retail businesses do not bear the burden of sales taxes. They are merely the collector for a tax paid by consumers. For the most part that is true with respect to retail stores which collect the tax at the cash register and bear little administrative burden in remitting the taxes to the state or local government.

That would not be the case with out-of-state mail order businesses. They would bear substantial administrative costs in collecting the sales tax -- far greater burdens than local retail businesses which are located in the state. That, of course, means that this legislation would create the perverse result that out-of-state mail order businesses would bear a greater relative burden from a state sales tax than would businesses located in the state.

I hope we can explore some of these issues in the hearing today. I look forward to receiving the testimony of the witnesses.

SUMMARY DESCRIPTION OF S. 639 AND S. 1099

RELATING TO

STATE TAXATION OF INTERSTATE SALES

INTRODUCTION

The Subcommittee on Taxation and Debt Management of the Senate Committee on Finance has scheduled a public hearing on November 6, 1987, on S. 639 (introduced by Senator Burdick) and S. 1099 (introduced by Senator Cochran). The bills would eliminate certain restrictions on the powers of a State in taxing sales in interstate commerce.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary description of present law, S. 639 and S. 1099, and an overview of the issues raised by the bills.

I. PRESENT LAW

Under the Constitution, a State or local government may impose taxes on sales that occur within its jurisdiction or on the use of property within its jurisdiction. (Approximately 6,700 State and local jurisdictions impose sales and use taxes.)[2] The allowable sales tax authority of a State or local government extends to mail order sales by out-of-State vendors to residents of the State if the sale is deemed to take place within the taxing jurisdiction.[3] There are, however, limitations on the methods State and local jurisdictions may employ to collect sales and use taxes.

State and local sales and use taxes are levied on the final purchaser, but are collected primarily through the vendor. In the case of a sale by an out-of-State vendor, the U.S. Supreme Court has held that the State or local government cannot constitutionally require the vendor to collect and remit use taxes unless the vendor has a sufficient business nexus with the State.[4] In the National Bellas Hess case, the Court found that the required nexus was not present where the vendor's only connection with customers in the State was by common carriers or the United States mail.[5] The Court based this conclusion on due process considerations and on the Commerce Clause of the United States Constitution, which reserves to Congress the power to regulate and control interstate commerce.[6] The required nexus has been held to exist where the vendor arranges sales through local agents or maintains retail stores in the taxing State.

II. DESCRIPTION OF PROPOSED LEGISLATION

S. 639--Senator Burdick

Under S. 639, any State (as well as the District of Columbia) or a political subdivision of a State could impose

a sales or use tax on tangible personal property sold by a person outside the State and delivered by common carrier or the United States Postal Service to a purchaser within the State.

S. 1099--Senator Cochran

Under S. 1099, any State (as well as the District of Columbia) could require sellers to collect a sales tax on sales of tangible personal property to be delivered (by any means of delivery) to a destination within the State. The obligation to collect the sales tax would be limited to sellers that regularly or systematically solicit sales in the State and have annual gross receipts exceeding $12,500,000 from sales of tangible personal property throughout the United States or exceeding $500,000 from sales within that State.

The sales tax must be imposed by the State and be uniform throughout the State for the State to be permitted to require out-of-State sellers to collect these taxes. In addition, a seller's obligation to collect tax on sales of tangible personal property would extend to local sales taxes, provided that (1) all local jurisdictions in the State impose a sales tax at the same rate on identical transactions in tangible personal property, and (2) the local sales tax is collected and administered by the State.

The bill would provide that States could not require sellers to file sales tax returns, or remit the receipts of a sales tax, more frequently than once every three months. In addition, States could not require any person who collects a sales tax to make an accounting for the receipts of the tax on the basis of the geographical location at which the taxable transactions occur.

III. OVERVIEW OF ISSUES

The purpose of each bill is to minimize the disparity between in-State and out-of-State vendors that arises from the constitutional limitation on the power of a State or local government to require collection and remission of sales or use tax by out-of-State vendors with no sales agents or retail stores in the State. Because State and local governments rely on vendors to collect and remit sales and use taxes on State residents, this constitutional limitation on the collection of these taxes generally has prevented the effective imposition of sales and use taxes on mail order sales by these out-of-State vendors. Accordingly, to the extent that purchasers can avoid sales or use tax liability by making mail order purchases from these out-of-State vendors, these vendors realize a competitive advantage in relation to in-State vendors (as well as in relation to out-of-State vendors with sales agents or retail stores in the State).

The bills might not completely eliminate the disparity between in-State and out-of-State vendors, in that the bills only relate to the taxation of tangible personal property. The scope of the sales and use taxes of several States is broader than that, extending, for example, to certain services and advertising.

Some argue that disparity of sales tax treatment of in-State and out-of-State vendors is undesirable for two reasons. First, they argue that equal tax treatment of in-State and out-of-State businesses is preferable to providing one type of business with a competitive advantage based solely upon the nonpayment of State taxes. Second, they assert that State and local governments should be

assisted in collecting all revenues to which they are entitled, particularly to the extent that their tax bases are affected by out-of-State mail order sales.

Others argue that Federal legislation should not be adopted addressing this issue even if the above arguments generally express the proper policy. They rely principally on two concerns--constitutionality and the administrative burden on vendors.

The constitutional issue arises under National Bellas Hess, in which the Supreme Court held that a State could not require an out-of-State mail order vendor with no local agents or local retail stores to collect and remit sales or use taxes with respect to its sales. Some observers note that because the mail order sales in National Bellas Hess were viewed as "exclusively interstate in character," the Supreme Court concluded that "this is a domain where Congress alone has the power of regulation and control."[7] Thus, these observers argue that Federal legislation authorizing State and local governments to require collection and remission by out-of-State vendors of sales or use taxes would remove the constitutional defect that the Supreme Court found. Other observers respond by arguing that National Bellas Hess requires a significant nexus between the out-of-State vendor and the taxing jurisdiction and that, on due process grounds, Congress may not be able constitutionally to dispense with this nexus requirement.

The issue of administrative burden arises because a mail order vendor, in order to comply with a requirement that it collect and remit sales and use taxes, would have to be familiar with the tax laws in all jurisdictions with respect to which the requirement arose. In light of the multiplicity of sales tax rules applying in different political subdivisions of States, S. 1099 seeks to reduce this complexity by providing for the collection of local tax only if the rate of tax is equal for all geographic areas in the State.

In its 1986 report,[8] the Advisory Commission on Intergovernmental Relations (ACIR) recommended that Federal legislation be enacted generally similar in intent to both bills.

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[1] This document may be cited as follows: Joint Committee on Taxation, Summary Description of S. 639 and S. 1099 Relating to State Taxation of Interstate Sales (JCX-19-87), November 5, 1987.

[2] Advisory Commission on Intergovernmental Relations, State and Local Taxation of Out-of-State Mail Order Sales (April 1986), p. 6.

[3] See, e.g., McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944).

[4] National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967) (henceforth referred to as National Bellas Hess).

[5] Id. at 754.

[6] Id. at 760.

[7] Id. at 759-60.

[8] See Note 2, above.

Senator Baucus, Good morning. The hearing of the Subcommittee on Taxation and Debt Management will come to order. Today's hearing is about a State's power to collect taxes. Few issues are more complicated, and few issues are more important.

The power to tax is a fundamental element of sovereignty, but it is subject to strict constitutional limits. More than 20 years ago, the Supreme Court held that these constitutional limits prevent States from taxing interstate mail order sales. This, the court said, is a domain where Congress alone has the power of regulation and control.

Since then, the mail order business has grown exponentially. We have seen the development of sophisticated direct mail operations, cable television, and computer marketing networks. Today, the interstate direct marketing is responsible for as much as $40 billion a year in product sales. Under the Supreme Court's decision, none of these sales are effectively subject to State sales taxes.

As a result, the States forego a large pool of revenue.

Two Senate bills would overturn the Supreme Court's decision. They would give States the power to require companies to collect sales taxes. These bills raise important issues; perhaps the most important is record-keeping.

Companies would have to keep track of the sales taxes of as many as 46 different States. That is no small task, and we would carefully consider whether this record-keeping is feasible and how it can be streamlined.

My home State of Montana is not directly affected. We don't have a sales tax. It is an issue that is hotly debated now in our State; so far, however, we do not have one. So, my State is not directly affected, but we have been involved very directly in unitary tax questions, severance tax questions; and so, I am very mindful of the importance the complication of this issue, that is, whether States have the power to require sellers to collect sales taxes in those States that do have a sales tax.

I am going to slightly change the witness order in deference to the chairman of the Environment and Public Works Committee, Senator Burdick. Senator Burdick is the sponsor of a bill that is before this subcommittee.

One of the first witnesses—but not the first witness—is the Honorable George Sinner, Governor of the State of North Dakota. Governor, why don't you be the first witness? Senator Burdick would like to introduce you.

Governor SINNER. Good morning, Senator.

Senator BAUCUS. Good morning. Senator Burdick?

Senator BURDICK. I am very pleased to introduce to the committee Governor George Sinner from the State of North Dakota. He will be testifying on behalf of the National Governors' Association. I know he has some very valuable information on this subject and I quite agree on what his position is; and I know the committee will be pleased to hear his statement.

And another matter, Mr. Chairman, I ask unanimous consent that my testimony of this subject, S. 639, be made a part of this record.

Senator BAUCUS. It will be part of the record.

I might add that Senator Cochran also will be filing a statement.

He is unable to be here today.

[The prepared written statements of Senators Burdick and Cochran follow:]

TESTIMONY SUBMITTED BY SENATOR QUENTIN BURDICK BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

S. 639

Mr. Chairman, I would first like to thank you for convening today's hearing. I am pleased that the Committee is taking this opportunity to study the issue and hopefully recognize the need for legislation to correct the inequity which now exists in mail order industry.

As it now stands, when a consumer purchases an item from an out-of-state mail order firm, he or she avoids paying the required sales tax to the state government. My bill would allow the state to require companies conducting mail order sales in the state to collect and submit the sales tax back to the state. It would eliminate the cost advantage which mail order firms now enjoy. It is a pure and simple case of "leveling the playing field", if I can use an overworked phrase.

If mail order business continues its upward spiral in the coming years, like many predict it will, more and more revenue will be lost by the states. At this time of dwindling federal assistance to states, every dollar of tax revenue that the states can collect is crucial in terms of their ability to

provide services to their residents. North Dakota loses an estimated $10 million annually due to tax-free mail order sales. That may seem like a pittance to larger states, but Governor of North Dakota will tell you differently.

By no means am I a foe of the mail order industry. Indeed, quite the opposite is true. Perhaps nobody enjoys more the convenience of purchasing items through the mail than do the residents of my state. Because North Dakota is one of the most rural states in the nation, thousands of my constituents are many miles from major retail centers which provide a wide variety of merchandise. So rather than drive a great distance, it is often much easier to order something out of the catalog and have it delivered right to your door or post office. Additionally, the harsh winter climate of many Northern States contributes to the desire of many consumers to choose mail order purchasing. For these people, convenience is the name of the game.

Mr. Chairman, the states need the revenue which this legislation would bring in. All this legislation does is treat all retailers the same. If you sell a product, you should have to submit the sales tax the same as in-state retailers must.

Mr. Chairman, thank you again for holding today's hearing.

STATEMENT OF SENATOR THAD COCHRAN

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

S. 1099, The Equity in Interstate Competition Act

November 6, 1987

Mr. Chairman, I want to commend you and this subcommittee for holding hearings on proposals that would eliminate restrictions on the taxing power of states to impose and collect sales and use taxes on interstate mail order sales.

I introduced S. 1099, the Equity in Interstate Competition Act, which would give the states authority to tax mail order sales. This legislation would correct a significant disparity in the application of state and local taxes which currently exists, and would provide a more uniform system of taxation to promote competitive equality for all business enterprises.

I am pleased that my colleague from Mississippi, Senator Stennis, as well as Senators Johnston and Exon have joined me in cosponsoring this legislation.

State governments are becoming increasingly concerned about their inability to collect sales and use taxes owed on out-of-state mail order purchases by their residents. As a result of the 1967 Supreme Court decision in the National Bellas Hess case, a state is barred from requiring an out-of-state mail order vendor to collect and remit the state's sales or use tax on sales made to customers in that

state if that firm does not meet a "minimum linkage" or "nexus" test in the taxing state.

With the emergence of various methods of interstate marketing of consumer goods, the states now lose $2 billion annually in sales tax revenue. At the same time, states' sales tax rates have risen in response to increased budgetary needs.

My own State of Mississippi depends heavily on the general sales tax as a source of state revenue. Nearly 50 percent of the revenues which go to support primary, secondary and higher education, health, welfare, corrections, and the other operations of government, comes from our general sales tax. Currently, about $440 million in general sales tax collections are derived from items which could easily be sold through interstate sales---sales which would escape taxation.

A study by the Advisory Commission on Intergovernmental Relations estimates that in 1986 Mississippi lost nearly $20 million in sales tax revenue as a result of sales to residents by out-of-state vendors. The estimated revenue potential from mail order sales over the next 2 years is expected to increase by 17% nationwide. Under this estimate, the State of Mississippi could face a potential loss of more than $50 million over the next two years.

It is important that Congress provide state governments with the opportunity to collect taxes on all sales to their residents. It is also important to remove unfair competitive disadvantages placed upon local businesses who contribute

services, convenience, property taxes, and charitable efforts to their communities.

S. 1099 attempts to address these problems by providing for the collection of uniformly-imposed state sales taxes and for uniform reporting procedures by large out-of-state vendors. The compliance burden on these vendors would be comparable to that now imposed on local retailers.

Similar legislation has been approved by the House Ways and Means Subcommittee on Select Revenue.

I thank the Chairman and the Subcommittee for the opportunity to be heard on this matter. I urge your favorable consideration of this legislation.

STATEMENT OF HON. GEORGE SINNER, GOVERNOR FROM THE STATE OF NORTH DAKOTA, ON BEHALF OF THE NATIONAL GOVERNORS' ASSOCIATION, ACCOMPANIED BY JAMES L. MARTIN, DIRECTOR, STATE-FEDERAL RELATIONS, NATIONAL GOVERNORS' ASSOCIATION

Governor SINNER. Thank you very much, Senator, and thank you, Senator Burdick, for your leadership on this issue as well. I am George Sinner, the Governor of North Dakota; and I appreciate the opportunity to appear before you today to offer testimony concerning S. 639 and S. 1099, bills that would correct the current problem of collecting mail order sales taxes. With me is Jim Martin from the National Governors' Association, who is the staff person who tracks this issue for the governors.

We represent not only the nation's governors but the State Working Group on the Collection of Mail Order Sales taxes as well. The roster of the members is attached to my testimony, which includes the National Association of Tax Administrators, the Multistate Tax Commission, the National Association of State Budget Officers, the National Association of State Auditors, Comptrollers, and Treasurers, and the National Conference of State Legislators.

The National Conference of State Legislators is separately represented today and is also an active member of the working group.

First, I would like to commend the subcommittee for focusing Congressional attention on this issue, which is very important to State governments. The States are obviously concerned about untaxed mail order sales because of the adverse revenue impact, but the primary concern of the States is the extreme unfairness it brings to retail sellers on the Main Streets of our States.

Mr. Chairman, five percent of gross sales is more dollars than most companies make in profit. A five percent sales advantage is an overwhelming advantage to the direct seller and an overwhelming disadvantage to the Main Street retailer.

We cannot allow this five percent competitive interstate disadvantage to continue. On page 2 of my testimony are some charts which will show what the average net income for retail businesses is in the United States as a percentage of gross sales. You will see there that for retail trade businesses 1.9 percent is the average net profit of these businesses as a percentage of gross sales. For all businesses in the United States, 3.5 percent of gross sales is the average net profit.

If you look below on some of the other levels, you will see that generally speaking you have the same figures. Now, the point is that this disadvantage that is placed on Main Street businesses is so overwhelming that it is no wonder that we see skyrocketing direct sellers avoiding the sales tax.

Second, I want to commend Senator Burdick and Senator Cochran for introducing bipartisan legislation to correct this problem. Both bills address the issue, and S. 1099 conforms to language the State groups have developed for both House and Senate consideration.

In summary, we support the language in S. 1099, which would make advertising the basis of tax collection, requiring each State to have a single tax rate, require no more than quarterly remittance,

and only apply to large firms with $12.5 million or more in annual sales. This provision alone exempts over 94 percent of all mail order firms.

As you know, in a 1967 decision, National Bellas Hess versus the Illinois Department of Revenue, the U.S. Supreme Court ended the obligation of out-of-State direct marketers and order sellers to collect sales or use taxes from buyers and remit the revenue to the home State of the purchaser.

Most of the 46 States, including the District of Columbia, which impose a sales tax on in-State purchases, also employ a complementary use tax on out-of-State purchases by their residents. In theory, the 1967 Supreme Court decision did not end the obligation of consumers to remit to their home State use tax on out-of-State purchases. The decision simply ended the requirement that out-of-State businesses collect the tax and remit it to the purchaser's home State.

Simply put, the Supreme Court said we can continue to impose a sales or use tax on mail order sales made by an out-of-State company, but we cannot require the company to collect and remit the tax. We must rely on consumers to voluntarily pay the tax to their home State revenue department—procedure that will not work for the collection of taxes.

The Federal Advisory Commission on Intergovernmental Relations estimates that the States are losing a minimum of $2 billion in revenue each year on untaxed mail order sales.

In North Dakota, it is estimated that we are losing about $5 million in revenue each year. You can imagine the impact on larger States. The impact of this revenue loss is severe, particularly in light of North Dakota's, and many of the other production States, precarious fiscal condition; and I have attached to the testimony a table that gives the estimated tax loss for each State.

Out-of-State businesses freely threaten the future of the sales tax, which is now the second most important State revenue source, accounting for one of every three State tax dollars. Fourteen States rely on sales taxes for more than 40 percent of their revenues. Seven States depend on sales taxes for more than half their revenues.

Furthermore, States have been increasing their dependence on sales taxes. From 1974 to 1984, the median sales tax rate rose from 3.8 percent to 4.4 percent. The increasing popularity of direct markets and border sellers is eroding the sales tax base. ACIR estimates that 38 of the 46 sales tax States lost at least $10 million in sales tax revenues in 1986.

I would like to comment parenthetically, too, that as we face the issue of competitiveness, we absolutely must cut down on production-based taxes. We did an estimate on what societally imposed costs do to production of coal in our State and found that about 35 percent of the cost of coal coming out of the ground are production-based taxes and that we find that foreign competitors do not have the same kind of production taxes; and so, we add to the problem of exchange rates and the overvalued dollar on our production sector.

My point is that more and more we are going to see the system, both national and State, I think, shifting towards the sales tax base

which taxes all products of all sources equally and getting away from production taxes.

The revenue impact of the 1967 Supreme Court decision has been exacerbated by the explosive growth in mail order sales. The Congressional Quarterly recently noted that consumers have gone on a mail order shopping spree, buying everything from expensive home computers and telephone equipment to a vast array of clothing, kitchen supplies, household tools, and other items sold by such companies as American Express, Sharper Image, Brookstone, and Lillian Vernon. I have a friend whose wife has been in China for three weeks. In the 21 days she was gone, 187 catalogs arrived at her mailbox. [Laughter.]

A farm friend of mine tells me that he spends on direct purchases from out-of-State firms monthly supplies approaching $1,000.00 every month. So, the trend is growing and much of it in big numbers that escape the sales tax.

Direct marketers whose solicitation methods include mail order catalogs, telephone selling, direct response commercials, advertising inserts, computer shopping, and other high tech methods run $150 billion a year businesses, accounting for 14 percent—as you mentioned—of all retail sales. By 1990 direct marketers are expected to control at least 20 percent of retail sales, according to the Direct Marketing Association.

Mr. Chairman, the law needs to be updated in light of these basic and growing changes in the marketplace. Changing technology will make mail order shopping more convenient than ever, with personal computers and cable television providing direct links between buyers and sellers.

Business Week, in December of 1986, in their report on home shopping, predicted that within three years almost anyone with a telephone and a television set will be able to shop at home. Home shopping sales hit $450 million in 1986 and, according to the industry analyst, Paul Kagan Associates, sales could pass $2 billion in 1987.

More than 50 million people—more than half of all the homes with television sets—will be able to tune into a home shopping program by late this year. The president of a company about to launch a cable television shopping program said the company will provide consumers with "a sort of electronic mall by combining the products of more than 100 catalogs in one program."

In addition to cable television's home shopping programs and computer shopping, major national retailers such as Bloomingdale's have established mail order businesses by setting up a separate corporate identity designed to permit interstate sales without the collection of the use tax.

The unfair advantage for out-of-State firms threatens the future of Main Street America. Sales by out-of-State firms are rising faster than those of traditional retailers at a conservative estimate of nine percent a year. Additional retail sales are increasing at about 5.7 percent a year.

Economist Ronald Fisher of Michigan State and John Mikesell of Indiana University estimate that a one percent increase in sales tax rate may reduce local retail sales by six percent as consumers find ways to beat the tax.

These sales losses to Main Street merchants are gains for direct marketers and clearly to border sellers as well.

Thus, retailers and State tax administrators are caught in a vicious cycle. Declining in-State retail sales force the sales tax rate up to make up for reduced revenue. Higher sales tax rates chase more customers to out-of-State firms, who have a price advantage equal to the tax rate in the consumer's home State.

ACIR concludes that the virtual tax immunity of out of State firms sends customers to direct marketers and border sellers. The tax-free appeal of mail order merchandise may increase with the recent enactment of the tax overhaul measures. The new law ends the deductibility of State sales taxes on Federal income tax returns; so, more consumers, particularly those buying bigger ticket items, will—in order to avoid paying a levy that they can no longer deduct—be lured to mail order business.

In North Dakota, we have 2,600 retailers, all of whom collect the 5.5 percent sales tax in our State. The untaxed sales transactions of their out-of-State competitors creates an unfair price advantage equal to the five percent tax rate of North Dakota whenever purchases are mailed or delivered into the State. Art Wheeler, the President of the North Dakota Retail Association, said:

> If direct marketers can continue to replace the American storefront, our nation's unemployment levels will have no bounds, for there may not be Main Street employers to provide jobs and livable incomes to wage-earners or neighbors and friends.

The North Dakota 49th Legislative Assembly adopted a formal request of Congress to adopt legislation which would allow States to require out-of-State companies to collect and remit sales tax on all transactions.

I am here today not only on behalf of NGA, but also on behalf of North Dakota and the nation-wide Main Street retailers who may not survive the competitive tax disadvantage that they are forced into by the mail order companies' ability to escape this tax.

Mr. Chairman, attached to my testimony is a copy of the current National Governors' Association policy, a roster of the State working group, a table on State revenue losses, and a list of the 71 cosponsors of similar legislation in the House. I might add that the House Ways and Means Committee yesterday marked up the bill, and I think reported it out.

We look forward to working with the committee to pass a bill which will restore the integrity of State sales taxes and eliminate the competitive advantage out-of-State businesses enjoy over our Main Street retailers. We commend the subcommittee for this hearing and urge you to press forward toward the reasonable and effective legislation that you have before you. Thank you very much.

Senator BAUCUS. Thank you, Governor. You make a good case on the lost revenue. I understand that States estimate that they would collect about $2 billion. On the other hand, as you well know, the sellers feel very, very strongly that if any of these bills pass, there will be a tremendous administrative burden placed upon them to collect the taxes and remit the taxes back to the States and Uncle Sam.

I am wondering: What compromise can you come up with? What potential resolutions come to mind in trying to find some common ground here between the States which are losing the revenue and the sellers who feel they would have to face a mess of an administrative burden if these bills were to pass?

Governor SINNER. Mr. Chairman, there are several compromises embodied in the bill. For example, the compromise really exempts all the small catalog companies; in fact, 94 percent of them are exempt by the de minimis requirement in there. In addition to that, there are really lots of catalog companies that do have nexus, that are now collecting the tax, and doing very well on an equal footing with the other merchants in this nation.

I find it a little bit dubious that the burden that is being suggested here is all that difficult, when so many companies—successful ones over the years—have always collected sales taxes. So, I think the argument is largely a specious one.

Senator BAUCUS. Are you saying that some direct mail firms do collect sales taxes?

Governor SINNER. Certainly, Sears and all kinds of companies that market through catalogs nation-wide do collect sales taxes. Penney's, for example, supports the legislation because they do collect the sales taxes.

Granted, there is going to be some more administrative burden. No one denies that, but every merchant has that. Every merchant in this nation has undertaken the burden of trying to help sustain the revenue sources for the States.

As the tax level rises, this thing becomes almost an overwhelming disadvantage for the local merchant. It is no wonder that they are going out of business all over the place.

Senator BAUCUS. What about the complexity issue that was raised? What if not only State sales taxes but also local sales taxes had to be collected by the direct seller? The seller would have to figure out a solution that includes 46 different jurisdictions—State jurisdictions in addition to all the local jurisdictions? And then, some articles are taxed in some way in one jurisdiction and not in another jurisdiction; you know, arguably, it is a very complex burden.

Governor SINNER. This bill does not include the local tax revenues.

Senator BAUCUS. So, you would then advocate only State sales taxes to be collected by direct sellers, or do you also want to include local sales taxes?

Governor SINNER. This bill and the effort that we have undertaken would only attempt to collect State sales taxes.

There is a compromise being proposed by the League of Cities, which would basically require that any uniform State tax be collected or that the revenue collected be shared equally. Now, we haven't polled all the governors as to their position on that. Governor Thompson and I, who are the two lead governors, have no objection to it; but we aren't saying that on behalf of the governors because we really haven't had a chance to poll the governors on that.

That issue, though, is really a separate issue. One that plays fundamentally here is the issue of State tax as being collected, and we

don't think that there is any unfairness in that effort at all to collect the State level sales tax.

Senator BAUCUS. What is your answer to the argument—the constitutional argument—that there is not a sufficient nexus, that is, that the States do not provide sufficient benefits to the direct mail seller in order to justify the State's laying an additional burden on the direct seller to collect the tax?

In the Sears case, there are Sears stores; and in the Montgomery Ward case, there are Montgomery Ward stores in the jurisdiction, and they have operations there. But if we are talking about solely direct mail sellers, the argument is that there is not a sufficient nexus, that the State does not provide sufficient benefits to the seller for the State to justify imposing the burden of collecting the tax on the seller.

Governor SINNER. It has always puzzled me that a direct seller will deliver a parcel by UPS to a buyer; but if the buyer refuses it or isn't there, they expect it back. They expect to hold property ownership claims on that piece of merchandise all the while it goes in and out of the State, all the while it is carried around the State on the State's roads. They expect to hold title if it is not delivered; and yet, they claim that they don't have any nexus in the State; their product is delivered over State roads.

I find that contention also pretty doubtful and really an attempt to escape what all of us as citizens in this country have to accept, and that is that there isn't any free lunch. Somewhere, we have to pay for the roads; we have to pay for the care of the elderly; we have to pay for the schools. And to give one market group an advantage of this proportion which, if you look at the dynamics of the percentage of profit in retail sales, it is an incredible advantage.

Senator BAUCUS. Thank you. Senator Mitchell?

Senator MITCHELL. Thank you, Mr. Chairman. I have a lengthy opening statement, which I would like to have placed in the record.

Senator BAUCUS. It will be placed in the record.

Senator MITCHELL. I would like to make just a few comments and then perhaps direct a question to the Governor.

In my view, the taxing power of States is not unlimited, and I believe there is serious question as to whether it is fair or constitutionally permissible for States to collect taxes from businesses which have little or no direct relationship with the States. The Supreme Court has ruled on the constitutionality of this issue; and although it is clearly stated that the States do not have the authority to collect sales taxes on out-of-State businesses, it is less clear whether Congress can grant States such powers under the Commerce Clause. That is a close question that will be before this subcommittee and the Congress.

Constitutional considerations aside, we have to decide whether it is appropriate for the taxing power of States to reach to businesses whose only connection to the State is through the mail. I believe opponents of this legislation present compelling arguments why it would not be appropriate for the taxing power of State and local governments to reach outside their jurisdictions to businesses located in other States. There are more than 6,000 State and local jurisdictions in this country which impose sales and use taxes.

It would be an intolerable burden on mail order businesses to determine the tax rate that applies to each sale throughout the nation, whether a particular item is exempt under local law or who the tax should be remitted to. Governments impose taxes as a means of financing government services.

It is, therefore, appropriate for the citizens of the State, through their local retail establishments, to pay taxes to finance government operations; but we must inquire whether it is appropriate for those out-of-State businesses which derive virtually no benefit from State services to bear such tax burdens.

In theory, we know that retail businesses do not bear the burden of sales taxes. They are merely the collector of taxes paid by consumers. For the most part, that is true with respect to retail stores which collect the tax at the cash register and bear little administrative burden in remitting the tax to the State or local government.

That would not be the case with out-of-State mail order businesses. They would bear substantial administrative costs in collecting the sales tax, far greater burdens than local retail businesses which are located in the State.

That, of course, would mean that this legislation would create the perverse result that out-of-State mail order businesses would bear a greater relative burden from a State sales tax than would businesses located within in the State, even though the benefit of services for the two would be directly to the contrary.

So, Mr. Chairman, I have very grave doubts about this legislation. I don't want to prolong the hearing. I thank the Governor for his testimony. I do have a number of questions for some of the other witnesses who will be coming here.

Senator BAUCUS. Thank you. Mr. Chairman, do you have any questions?

Senator BURDICK. Not being a member of the committee, I think I will rely simply on my statement that I filed with the committee, generally supporting the Governor in his position.

Senator BAUCUS. Thank you.

Governor Sinner. Mr. Chairman, I have Governor Thompson's testimony that I will leave with the committee.

I just want to add one additional thing in response to Senator Mitchell's comments. The States do not wish to impose the tax on the shipper. This is a consumer tax. All we ask of these citizens of this country is that they collect the tax like other merchants do who, in addition to this tax, pay property taxes and income taxes and all the other local taxes that are levied.

I realize that everyone is entitled to his position on the legality of this; but in the vote of the governors, there was not a single dissenting voice vote from any governor in support of the policy to get this revised, because the governors all recognize the gross unfairness that is being perpetrated here.

Senator BAUCUS. Thank you, Governor. We appreciate your testimony.

Our next witness is Mr. Dennis Ross, who is the Tax Legislative Counsel, Office of the Assistant Secretary for Tax Policy, Department of the Treasury.

We appreciate your coming, Mr. Ross. Why don't you proceed?

Mr. Ross. Thank you, Mr. Chairman.

Senator BAUCUS. We have a vote in progress. It is a half an hour vote. I think we will be able to proceed continuously. So, why don't you proceed Mr. Ross?

STATEMENT OF DENNIS E. ROSS, TAX LEGISLATIVE COUNSEL, OFFICE OF THE ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. Ross. All right. Thank you, Mr. Chairman. I am pleased for the opportunity to be here and present the Treasury Department's views on these two bills, S. 639 and S. 1099, each of which seeks to expand the power of State and local governments to require out-of-State retailers to collect State sales and use taxes on interstate sales.

These bills—as I think the previous witness suggested—are intended to reverse the 1967 Supreme Court decision, National Bellas Hess, which held that the Commerce Clause of the Constitution limits the State's authority to require an out-of-State retailer to collect that State's sales or use tax.

I should note that S. 639 and S. 1099 are similar to a bill before the House, H.R. 1242, which is also designed to expand the power of States in this area. The Treasury Department testified on H.R. 1242 earlier this year before a House Ways and Means subcommittee. At that time, we expressed out strong opposition to a provision in that bill that would effectively have engaged the Internal Revenue Service in the enforcement of State sales taxes through a Federal information reporting system involving interstate sales.

I am very pleased to note that neither S. 639 nor S. 1099 contains that provision, and we view that, as I say, as a significant improvement over the House version of this legislation.

By way of background, Mr. Chairman, State sales taxes, represent an extremely important source of State revenues. Recent data from 1986 indicate that sales tax revenues were nearly $75 billion, accounting for over 30 percent of all State tax revenues. State sales taxes are generally single rate, ad valorem taxes imposed on various types of personal property sold at retail within the State; and the rate of sales tax varies, of course, among the various States, as does the range of items subject to tax.

As you know, a number of States provide important exemptions from their sales tax, extending to items such as food, clothing, medical supplies, and others.

States also vary in the form of their sales tax. In most States, the tax is imposed directly on retail sales; but in some, the legal form of the tax is an occupational or privilege tax imposed actually on retail vendors. In either form of the tax, however, the tax is effectively passed on to the consumer and generally is separately stated as part of the consumer's purchase price.

States that impose sales taxes generally also impose so-called compensating use taxes on the storage, use, or consumption of property that would be subject to the State sales tax but for the fact that the property was purchased outside the taxing State.

Now, generally, the State in which a vendor conducts a taxable business operation does not impose a sales tax on property deliv-

ered outside that State to residents of another State. Such property would be subject to the sales and use tax imposed by the State in which the consumer resides, with the out-of-State vendor usually required to collect the tax on sales to residents of that taxing State; but if no out-of-State vendor has collected the sales or use tax of the taxing State, the consumer bringing that taxable property into the taxing State is liable for payment of the use tax.

As a practical matter, however, States generally are unable to collect use taxes from individual consumers.

Mr. Chairman, as you know and as again was discussed in the prior witness's testimony, State taxation of interstate commercial transactions is subject to Federal constitutional limitations. Specifically, under judicial decisions based both in the Commerce Clause and the Due Process Clause of the 14th Amendment, State taxation falling on interstate commerce or nonresident persons violates the Constitution if the object of the State's taxation does not benefit from State governmental activities.

In particular, out-of-State vendors may be required to collect another State's sales or use tax only if the out of State vendor has sufficient business contacts or nexus with the taxing State; and of course, a leading case illustrating this principle is National Bellas Hess, the 1967 Supreme Court decision, where the court found unconstitutional a State's imposition of the duty to collect a State use tax on an out-of-State mail order retailer who advertised in the taxing State only through mailed catalogs and circulars and delivered ordered products in the taxing State through a common carrier.

Mr. Chairman, given the nature of State sales tax collection efforts and the state of current law, States that impose sales and use taxes have an understandable concern that such taxes are widely avoided on purchases of goods from out-of-State vendors. Under the Bellas Hess line of authority, States cannot legally require many out-of-State vendors to collect their State sales tax; and enforcement against individual consumers, as I noted, is generally impractical.

Some estimates of the lost sales tax revenue from interstate mail order sales are in the range of $1.5 billion per year.

Let me turn now, Mr. Chairman, to the specific provisions of S. 639 and S. 1099. Each of the bills would attempt to draw on Congress' authority under the Commerce Clause to regulate interstate commerce in order to expand the power of the States to impose sales and use tax collection obligations on out-of-State retailers. S. 1099 provides that a State shall have the power to require an out-of-State seller to collect the State sales tax if the destination of the sale is within the taxing State. This authority is, however, limited to out-of-State sellers that engage in regular or systematic soliciting of sales within the taxing State; and in addition, the out-of-State seller must have annual gross receipts from the sale of property that either exceed $12,500,000 per year nationwide or, alternatively, exceed $500,000 per year within the taxing State.

Now, finally, S. 1099 would apply to sales taxes imposed by a local government only if the local tax is collected and administered by the State government and if, essentially, the local tax is uniform throughout the State.

Although S. 639 is designed to achieve the same general ends as S. 1099, it has several important differences.

S. 639 provides that any State or political subdivision thereof shall have the power to impose a sales or use tax on any interstate sale of tangible personal property by a person located outside such State or political subdivision.

Unlike S. 1099, S. 639 would not require that an out-of-State seller regularly solicits sales within the taxing State or indeed have any other nexus with the taxing State. S. 639 would also not limit its provisions to retailers of a certain size and would not limit the type or variety of local sales taxes that might be applied to out-of-State vendors. We believe, because of S. 639's broad extension of State and local taxing authority, its adoption could result in unreasonable compliance burdens being imposed on out-of-State retailers.

Under the bill's provisions, out-of-State retailers, regardless of size or sophistication on the level of sales or advertising activity in a given State or locality, could be faced with complex reporting and collection obligations for multiple taxing jurisdictions. Since the limitations adopted in S. 1099 should not unduly restrict State tax collection efforts, we believe its approach to the problem of out-of-State sales tax collection is far preferable.

Finally, Mr. Chairman, although the Treasury Department does not view either S. 639 or S. 1099 as legislation raising significant Federal tax policy issues, I would like to express a general concern regarding the effect of these bills.

In particular, it is not clear that either of these bills would fully resolve the constitutional issues that currently prevent States from requiring out-of-State vendors to collect sales and use taxes. As I stated earlier, two different constitutional limitations are involved with respect to this issue: the first residing in the Commerce Clause and the second the Due Process Clause of the 14th Amendment.

Although each of these limitations on State authority focuses on the same basic issue, that is, the taxing State's nexus with the out-of-State vendor, they are separate and independent legal barriers. Although S. 639 and S. 1099 would likely clarify the scope of the Commerce Clause limitations on State's authority with respect to out-of-State vendors, we are concerned that neither bill would resolve the analogous issues that may arise under the Due Process Clause. As you know, the Commerce Clause vests Congress with exclusive authority to make laws respecting interstate trade, and thus Congress may be able to prescribe Federal standards for the requisite business nexus to support State imposition of sales and use tax collection obligations on out-of-State sellers.

The Due Process Clause, however, does not vest Congress with similar authority to establish minimum standards of due process. As a consequence, it is not clear that Federal legislation prescribing minimum nexus requirements would affect the otherwise applicable limitations of the Due Process Clause. Although we express no opinion as to this issue, it is thus possible that S. 1099 and S. 639 would not affect the result reached in Bellas Hess, other than to shift the formal grounds for that decision from the Commerce Clause to the Due Process Clause.

Mr. Chairman, that concludes my prepared remarks, and I would, of course, be pleased to respond to any of your questions.

Senator BAUCUS. Thank you, Mr. Ross. Has Treasury looked at any potential revenue effects of these bills? I ask that because there is some concern that administrative costs—the collection costs—of direct sellers will lower their tax payments to Uncle Sam. The direct sellers are looking into that.

Mr. Ross. Yes.

Senator BAUCUS. They think there is a significant effect. I am wondering whether Treasury has looked into that.

Mr. Ross. Frankly, Mr. Chairman, we have not; and I am not sure we have actually thought that through, but certainly one could see a possibility that there are significant administrative costs involved here that will limit or reduce the income of the out-of-State sellers and presumably reduce any Federal income tax obligation they have. That is not an issue that we have looked at.

It is something that, if you are interested in it, we certainly can take a look at it.

[Submission for the record: The federal revenue effect of this legislation would be negligible.]

Senator BAUCUS. I think it would be helpful if you would.

Mr. Ross. Sure.

Senator BAUCUS. Second, I think in your prepared testimony, you mentioned a potential trade problem. That is, what about foreign direct sellers? What is your concern there?

Mr. Ross. We have a concern as to how other nations would regard this legislation, if it were viewed as imposing some sort of collection obligation not simply on out-of-State sellers but out-of-country sellers. We are not quite clear as to what the intention of the legislation is in that regard.

We do not think that this is necessarily a GATT problem. In fact, I think our judgment is that it would not be; but there could well be an adverse reaction from other nations, viewing this as an inappropriate extension of U.S. taxing authority.

Senator BAUCUS. Thank you. Senator Mitchell.

Senator MITCHELL. I have no questions. I apologize to Mr. Ross for missing his testimony; I had to go vote. I will review it later.

Senator BAUCUS. Thank you very much, Mr. Ross. We appreciate your testimony.

I will call the next panel now, and Senator Mitchell will be here during the next panel while I go and vote.

The next panel consists of The Honorable Ray Farabee, State Senator from Wichita Falls, Texas, testifying on behalf of the National Conference of State Legislatures; Mr. John R. Baldwin, President of the National Association of Tax Administrators and Director of the New Jersey Division of Taxation, and Mr. R.H. Hansen, Chairman of the Multi State Tax Commission and Chairman of the Utah State Tax Commission, who are both testifying on behalf of the National Association of Tax Administrators; and Ms. Cathy Reynolds, Councilmember at Large in Denver and President of the National League of Cities, Denver, Colorado.

Senator Farabee, why don't you begin?

STATEMENT OF HON. RAY FARABEE, STATE SENATOR, WICHITA FALLS, TX, TESTIFYING ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

Senator FARABEE. Thank you, Mr. Chairman. My name is Ray Farabee. I am a member of the State Senate from Texas. I am appearing today in support of Senate 639 and Senate 1099.

I am here representing the National Conference of State Legislatures, which represents the 50 State legislatures of our country. This matter, growing out of the National Bellas Hess case, has been of increasing concern to State legislatures; and that involves the fact that increasingly our States have relied on the sales tax. This is particularly true in my home State of Texas, where we rely on revenues from the sales tax for more than 50 percent of our income to carry out the various State services, as many of them are in partnership with the Federal Government such as Medicaid.

It was just raised so that the State sales tax rate is six percent. In addition to that, I would guess that 99 percent or more of the cities have a one cent sales tax. And in addition to that, there is a Metropolitan Transit Authority tax in the metropolitan areas of Dallas/Fort Worth and in Houston, San Antonio, Austin and, I believe, El Paso.

Senator MITCHELL. Is that a sales tax?

Senator FARABEE. Those are sales taxes, too.

Senator MITCHELL. They are?

Senator FARABEE. Yes. The National Conference of State Legislatures has passed a resolution of strong support for legislation similar to this and similar to that of Congressman Jack Brooks from the State of Texas and other Members of Congress in the House.

There are basically four areas that we would address. Governor Sinner, I think, touched upon many of the specific factual matters; but we would stress these four areas as being important for consideration of this legislation and hopefully favorable passage.

One, the changing markets, in the sense that at the time of the National Bellas Hess case, which was a split decision, it was quite a different scenario when those facts arose, although National Bellas Hess was no small direct seller, according to the facts of the case.

Since that time, though, with the development of toll-free numbers, with express delivery systems that far exceed what we knew then, and with the upcoming—and actually, it is in place now, but not to the extent anticipated—sales through cable television and electronic media, the marketplace is quite different. The fact is that the direct sellers have an important presence in my household and in the households throughout my district and throughout, I think, each community in our country. So, we would hope that the committee and the Senate consider those important changes that are occurring in the marketplace.

Second is the issue of fairness and interstate competition in the sense that it is understandable that there is some burden to collect sales tax, as the chairman has pointed out; but the chair correctly pointed out that, contrary to some popular understanding, the obligation is there to pay the sales tax. The National Bellas Hess case did not repeal the obligation to pay a use tax on goods purchased

from out of State, but it simply dealt then with the obligation to collect that tax.

But whether it is Heidenheimer's Hardware Store in Haskell, Texas in my district or whether it is a catalog house in some other part of the country, that is a burden that certainly Heidenheimer's undertakes. It is a burden that Sears Roebuck and J.C. Penney undertake. And it seems to me that it is a burden that is necessary to maintain essential services that provide a marketplace, which is one of the most important elements of presence I think, which Judge Fortas saw and perhaps Judge Potter Stewart did not see.

But if you don't have a marketplace, then you don't make many sales either from the people in the community on Main Street or from the people that approach you through catalogs in the mail, on the television, and through the telephone system; and the States are very directly involved in that, and there is a substantial benefit. But the local merchant increasingly has a more difficult point of competing. As an example, in the State of Texas, there is just going in an eight percent differential in most of the communities because of the six cent sales tax and because of the penny city sales tax and because—in most of the population of Texas, at least—another penny for the Metropolitan Transit Authority tax.

So, that competitive edge and the equity concept is important for the local merchant and also for those merchants—some of which are quite large, like Sears—that do have stores, that have physical presence in each of the States.

The next point is that, rather than just raising taxes, we ought to focus first on how can we develop a fairer, more equitable, efficient tax collection system, whether it is at the local level of improving property tax collection, whether it is at the Federal level in trying to bring about a change in our Federal income tax system to make it more uniform, equal and equitable; or whether, in this instance, it is our sales tax and application of that in a uniform way.

The estimates range between 12 and 14 percent of the number of sales that are made through the process of out of State direct sales—catalog type—and that is growing; and it is estimated that that will be 20 percent by the early part of the next decade.

Finally, the argument is put forth that this would be an undue burden on these persons, particularly if you added the local sales tax, which will vary since you have only 50 States. I would simply say that we have made important progress with computers and other ways to take care of much of that; and also, hopefully, that would be handled in the legislation to minimize the burden on the direct sellers.

Senator MITCHELL. Thank you very much, Senator Farabee, for a very persuasive statement. Mr. Baldwin, I understand that you and Mr. Hansen are appearing together and will divide your time between you?

Mr. BALDWIN. That is correct.

Senator MITCHELL. Then, welcome. We look forward to hearing from you.

STATEMENT OF JOHN R. BALDWIN, PRESIDENT, NATIONAL ASSOCIATION OF TAX ADMINISTRATORS, AND DIRECTOR, NEW JERSEY, DIVISION OF TAXATION, TRENTON, NJ, TESTIFYING ON BEHALF OF THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS

Mr. BALDWIN. Thank you, Mr. Chairman. My name is John R. Baldwin. I am Director of the New Jersey Division of Taxation. This year I am privileged to serve as President of the National Association of Tax Administrators. I am joined this morning on my immediate right by the Honorable R. Hal Hansen, who is Chairman of the Utah State Tax Commission and the current Chairman of the Multi State Tax Commission.

As you pointed out, our statement will be a joint one here this morning. NATA and MTC wish to express their appreciation to the subcommittee for its invitation to discuss mail order sales tax evasion problems with you here this morning. NATA and MTC strongly support S. 1099 and the objectives of S. 639. This legislation would end a grossly unfair tax advantage which out-of-State business now enjoys over local business. It would also provide the States with $2 million in annual sales tax revenue needed by State and local governments for critical expenditure purposes.

My brief comments this morning will deal with several of the principal concerns expressed by NATA and MTC in the statement submitted to the subcommittee.

S. 1099 would restore the taxing authority to the States removed in 1967 by the Supreme Court in a six-to-three decision, National Bellas Hess versus Illinois Department of Revenue, rule that the States could not require an out-of-State seller to collect sales and use taxes even though it engaged in continuous advertising in the State.

In 1967, the impact of that ruling was disturbing, but in recent years that impact has grown explosively, as the sale of consumer goods through interstate marketing has emerged as a business phenomenon with credit card companies, computers, 800 telephone numbers, television cable advertising, and home shopping clubs. Home shopping clubs have been described as a revolution in marketing.

Three years ago, a study by the Advisory Commission on Intergovernmental Relations estimated State revenue losses attributable to out-of-State mail order sales at $1.5 million. They now estimate from 1986 figures a revenue loss of conservatively $2 billion.

Moreover, this revenue loss does not include estimates from purchases attributable to TV home shopping clubs. Adding this would raise the loss to well over $3 billion annually.

State revenue losses, plus the tax advantages of those out-of-State sellers who can sell tax-free, they enjoy a competitive edge of over six percent or more in over half of those 46 sales tax States. The State tax agencies repeatedly hear complaints from local retailers that they are hard pressed and may have to go out of business because they cannot match the prices for their tax-free out-of-State competitors.

Unless Congress enacts legislation nullifying the National Bellas Hess decision, States cannot respond to the local retailers' complaints about out-of-State sellers' competitive advantage.

The National Bellas Hess decision, in effect, gives consumers the option of paying sales taxes if they wish and encourages local retailers to avoid paying the taxes if they choose to purchase merchandise out of State.

We believe that is a threat to Main Street America.

NATA has conducted a study done by our peers which shows that legal authorities analyzing the issue have concluded that Congress may constitutionally permit States to collect sales and use taxes from mail order vendors. Leading authorities take the view that National Bellas Hess was decided on Commerce Clause grounds and not on Due Process grounds and that the Supreme Court, without impediment, could uphold congressional action to nullify National Bellas Hess.

There are also legal authorities who describe as favorable the prospects for the U.S. Supreme Court decision negating National Bellas Hess. They view the majority decision as questionable law and unrealistic in terms of current marketing practices. During the past year, at least a half dozen States have enacted laws which directly challenge the National Bellas Hess decision. And of these laws may result in litigation on the issue.

For States, local retailers, and the direct marketing business, Federal legislation such as S. 1099 would be preferable to extended litigation. For the direct marketing business, S. 1099 provides a gross sales threshold below which mail order firms would be relieved of all compliance requirements. It also provides for uniformity among the States with respect to rate, base, and reporting procedures.

If Federal legislation is not passed, and National Bellas Hess is negated by the courts, the direct marketers would be subject to a myriad of diverse State requirements that could be much more complex than the simple uniform requirements called for in S. 1099.

For the States, Federal legislation would be beneficial because it would resolve a major tax problem and would avoid the escalation that would result from the rapidly accelerating growth in interstate sales. For local retailers, S. 1099 would provide a level playing field and prompt relief from an unfair competitive threat which could cause a multitude of bankruptcies before litigation over the issue could be resolved.

Again, Mr. Chairman, NATA and MTC express their thanks to the subcommittee for its invitation to be here this morning to present this testimony. We stand ready to provide the subcommittee with any additional information they need in considering this highly desirable legislation.

Mr. Chairman, if I can conclude my testimony with an anecdote, I think that it addresses the complexity issue. Just about 10 days ago, a friend of mine in New Jersey ordered a shirt from a large East Coast mail order firm. He called an 800 number to complete the transaction, and while he was on the phone, a girl on the other end of the line said: "Oh, Mr. Jones, your neck size has increased by half a size since you last ordered a shirt."

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Now, under this legislation, there are 46 sets of sales tax provisions, and I don't know if a mail order company knows that there are seven and a half million necks in New Jersey. [Laughter.]

So, I think if they can keep track of people's neck sizes, they can keep track of the States' sales tax provisions. Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Mr. Baldwin. Mr. Hansen?

[The prepared statement of Mr. Baldwin follows:]

STATEMENT OF R.H. HANSEN, CHAIRMAN, MULTISTATE TAX COMMISSION, AND CHAIRMAN, UTAH STATE TAX COMMISSION, SALT LAKE CITY, UT, TESTIFYING ON BEHALF OF THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS

Mr. HANSEN. Thank you, Mr. Chairman. I appreciate the opportunity to be here and I support the comments made by my colleague. There were a couple questions that came up this morning that may not have been answered on the local tax issue. The revenue coming through this particular legislation would include local sales taxes that are collected by the States. The question raised by the cities and towns related to whether it would be distributed by the States to those cities and towns.

The solution that we see would be to distribute these in the same proportion regular sales tax revenues are being distributed in the State.

Now, another question that has been brought up is on the equity issue. This is a lot of revenue to the States, but I see the equity issue as one of pressure that is coming from the local merchants and retailers who are decidedly at a competitive disadvantage; and they are very concerned with the equity issue. The cost of collection, that is, the administrative cost, is one I can recognize myself.

I have been in business myself. In Utah, the issue was raised as to the administrative cost of collecting. Our solution in Utah was to remit every three months. In that way, the merchant has the use of that money for a two to three month period. For those who say it costs more than that—if they can show it costs more than that—we will provide relief.

So, the use of that money during that period of time certainly does help negate the administrative costs.

The Multi State Tax Commission has incorporated 29 States to help support an attempt to overcome the burdens of National Bellas Hess. In negotiations with mail order companies, 318 direct marketers were contacted by questionnaire; only 53 responded. Most of those 53 responded that they were not liable to collect the tax.

Of those who did agree to the liability, we have identified approximately $300 million per year that will be paid in the future.

But we consider this a failure. Although $300 million looks like a lot of money, in contrast to the $2 billion we could be looking at, we consider it a failure.

The honest taxpayer who wants to pay use tax on these items can do so. Businesses that order through the mail, we can identify and audit them for the use tax. For the consumer with the catalog at home, there is not a practical way to collect these taxes.

Last year we put a line on the income tax form so that a person could voluntarily indicate how much they would owe. We collected $100,000 from those who recognized they owed it and paid it with their income tax but, compared to the $13 million that should have come in, we consider this program to be a failure.

In Utah, as in many other States, our legislature has passed a resolution encouraging national legislation that will give relief to the Main Street merchants, and to give relief to the State. The equity issue, the income issue, the local government issue are problems that need to be worked on, but we certainly support the proposed legislation before this subcommittee.

Senator BAUCUS. Thank you, Mr. Hansen. Ms. Reynolds?

STATEMENT OF CATHY REYNOLDS, COUNCILMEMBER-AT-LARGE, DENVER, AND PRESIDENT, NATIONAL LEAGUE OF CITIES, DENVER, CO

Ms. REYNOLDS. Thank you, Mr. Chairman. Good morning. My name is Cathy Reynolds. I am an At-Large Council Member of the City Council of Denver, Colorado, and also serve as President of the National League of Cities. I am appearing for the National League of Cities as well as the City of Denver here this morning.

NLC represents some 16,000 cities and towns across the country, and we urge your support for legislation that would authorize the collection of both local and States sales taxes on interstate mail order sales.

A subcommittee of the House Ways and Means Committee took a first step in the legislative process in marking up the legislation. Unfortunately, the legislation as approved by the subcommittee would not ensure that cities and other local governments will receive their fair share or any share of the revenue collected under the legislation.

Some organizations representing State interests are opposed to Federal legislation which would require the sharing of revenues with local governments. The sponsor of the legislation in the House has agreed in principle that the interests of local governments should be safeguarded and has asked that the State and local organizations seek to iron out their differences through high-level negotiations.

While we are optimistic, we believe that these difficult issues must be resolved in a manner that is satisfactory to protect the tax base of local communities before the final legislation is passed. We are surprised by some of the arguments put forth by some of the State interests. The Supreme Court decision in the National Bellas Hess case made it clear the taxes imposed on interstate mail order sales is a Federal matter.

It is clear that Congress can establish simplified and streamlined procedures for collecting sales taxes if it so desires. These procedures may cover such matters as mandatory distribution by the State of a proportion of the sales tax collected to local governments.

Some 6,705 local jurisdictions in 29 States levied a sales tax in 1986. In my own City of Denver, our 3.5 percent sales tax produced $150 million in 1985, over 50 percent of our general fund revenues.

For some cities, sales tax revenues constitute an even greater percentage of local tax revenues: 64 percent in Huntsville, Alabama; 76 percent in Colorado Springs, Colorado; 60 percent in Baton Rouge, Louisiana; and 78 percent in Tulsa, Oklahoma.

Current direct marketing sales are at $150 billion annually, that is 14 percent of all retail sales. By 1990, direct marketing is expected to account for 20 percent of all retail sales. Six billion catalogs from 6,500 direct marketers were mailed to consumers in 1985. Catalog sales for the first quarter of 1985 were 19 percent higher than for the same period in 1984. In addition, retail sales rose only 5.7 percent in the same period.

These numbers and others lead us to a real concern about the erosion of local and State tax bases due to retail sales through the mail. We would also like to emphasize that this is not a tax on the catalog sales in other parts of the country; this is a tax on our local consumer that he would pay if he went down on Main Street, as my friends put it, rather than buying through a catalog.

There are two bills pending now in the Senate on this, S. 639 and S. 1099. S. 639, although technically flawed, recognizes that local sales taxes as well as State sales taxes should be covered by the legislation. S. 1099, on the other hand, fails to protect the interests of local governments.

S. 1099 effectively bars the collection of local sales taxes, while authorizing the collection of State sales taxes. Under this bill, local sales taxes may be collected only if local rates and coverage are uniform throughout the State.

Due to various aberrations in local sales taxes, there is no State with a local sales tax structure which meets this requirement. We understand that the primary obstacle to coverage of local governments is a fear that such a provision would create administrative problems for retailers. We believe that these concerns are greatly overstated.

However, we also believe that a streamlined collection process can be established which minimizes administrative burdens in collections.

I would like to discuss two possible approaches. Under the first, revenue collection would be maximized. Under the second, revenues would be lower, but the additional administrative burden on the seller for the collection of local sales taxes would be virtually nonexistent.

Our first approach—our preferred approach—is to establish streamlined collection and remittance procedures which reduce the costs associated with vendor collection of local sales tax. Under this approach, both States and local governments could recover virtually all sales tax revenues owed under State and local law.

Collection procedures are as follows: Collection costs can be reduced by the establishment of a national clearinghouse to provide up-to-date information to both sellers and buyers via a cost-free "800" telephone number.

Remittance procedures are: Remittance costs could be minimized by establishing a zip code-based system of information returns and revenue distribution requiring only one return per State. The State then would be required to distribute the applicable tax receipts to

the appropriate local jurisdiction on the basis of the zip code information.

Our second approach is a compromise proposal which would result in lower revenue collections for States and cities in a number of States; a single sales tax rate would be imposed on all interstate sales to residents of the State, with the resulting revenues to be divided among governmental units in accordance with their pro rata share of normal State-wide sales tax receipts. The tax would be collected at the State rate or a uniform State/local rate. The combined State/local rate would be collected only if a uniform rate or a uniform minimum rate existed.

Under this approach, local sales taxes would be collected where local sales taxes would impose no added administrative burdens on retailers.

In any State where local governments impose a local sales tax, the State would be required to pass through a portion of the sales tax revenues collected on interstate sales. Tax receipts would be allocated between the State government and the State's local governments in accordance with each jurisdiction's proportional share of normal sales tax revenues for the previous year.

In closing, Mr. Chairman, I would like to stress the importance of addressing the fundamental needs of local governments as well as State governments. While we stand ready to support procedures which minimize the administrative burdens on retailers, we are opposed to any proposal that would deny cities their fair share of the revenues. We are hopeful that our discussions with representatives of the State governments will be fruitful. We are prepared to work with other organizations as well as this subcommittee to develop streamlined and fair procedures to address the problem with which we are all concerned.

Thank you.

Senator BAUCUS. Thank you, Ms. Reynolds.

Senator BAUCUS. I am wondering if the four of you could comment on the provisions of the House bill regarding the de minimis provisions.

Do you agree with the de minimis provisions; and if so, what should they be?

Ms. REYNOLDS. My organization has not had a chance to make any formal decision on those. I believe, however, given the history of how this subject has been handled, that provisions that deal with some threshold level would probably be satisfactory once the numbers are arrived at and those thresholds are established. We are not out to gouge anyone, especially the small businessman. We are simply out to try to make tax collections fair for everyone.

Senator BAUCUS. Do you have some comments, Mr. Baldwin?

Mr. BALDWIN. Yes, Mr. Chairman. The $12.5 million national and $500,000 for a given State had its origins in a draft prepared by the National Association of Tax Administrators after many, many hours of work. Governor Sinner testified today that those minimum standards would cover about 94 percent of the mail order businesses in the United States. The Tax Administrators, speaking both for NATA and MTC think that is generous.

We think the $12.5 million and $500,000 de minimis standards are reasonable, Mr. Chairman.

Senator BAUCUS. Anyone else?

Senator FARABEE. Mr. Chairman, the National Conference of State Legislatures has not addressed that issue in its policy. However, in our negotiations, it is recognized that that is a reasonable way to go about the definition of regulation of interstate commerce which remains a legal issue in this matter of due process, and we would be supportive of that threshold or the de minimis level expressed here.

Senator BAUCUS. I wonder if you would address the nexus question relating to direct sellers. This is your opportunity now. We are going to have other witnesses here today who are going to claim that States do not provide sufficient benefits to justify the administrative burden of their collecting the State taxes.

Why don't you point out why you think that this is sufficient nexus on the part of the States, if you do?

Senator FARABEE. Let me mention just a few. The heart of any sales organization is the marketplace. And without a marketplace, you aren't going to have any sales, either in the store on Main Street or in the catalog house in Chicago. And that marketplace is supported by a number of State services, whether it is in education, which provides the economic wherewithal, generally to be able to buy things—particularly to buy things through a catalog house—or whether it is a Federal/State partnership in taking care of those problems which is also an important part of the economy, or whether it is the transportation system which provides the roads and highways for getting those goods to the buyers. You have also the enforcement mechanism.

If someone doesn't pay their bill to L. L. Bean or to another catalog house, I assure you that they will be using the State courts to enforce those obligations. Then, you have the whole regulatory system which the State provides in telecommunications, whether it is the Public Utility Commission in Texas or some other organization that deals with telephone rates and that will deal undoubtedly with certain other aspects of communications that will be important to this.

So, I think that is just the beginning; and as Judge Fortas said in his dissent, the majority opinion was extremely mechanistic in saying that you have to have a physical presence of one human being at least or a warehouse or a store.

Senator BAUCUS. Anyone else?

Ms. REYNOLDS. Yes, sir, if I might comment? Remember that I am on the city council, so my first automatic response is: Well, if they are mailing out six billion catalogs, who do you think takes the trash away for six billion catalogs? [Laughter.]

I think the comments made by my colleagues are right on the mark in terms of the nexus that you are talking about, the direct linkage between the service and a tax. I think it is important for us all to keep in mind—although that is an important legal question—that we are not taxing the catalog house; we are taxing the consumer.

Wherever that consumer buys his goods, he should pay whatever the local sales tax is.

I think that the points that my friend on my right made earlier about the use of the money covering any cost of collection they

might have and, if it could be proved that the costs were greater than that, then we would certainly be willing to talk about some remittance to cover the cost of collection. The remarks Governor Sinner made earlier in the morning about the delivery of the articles, the fact they must have to be returned; the roads are used; the legal system is used. Somebody's local services are being impacted by the fact that that item comes into the community.

It is obviously not as clear as Montgomery Ward having a store in your town and in my town; but I believe it is clear enough to answer the legal questions if we have the political will to address the matter at all.

Mr. BALDWIN. Mr. Chairman, I think Senator Farabee pretty much summarized our view of this issue. Basically, it is all tied up in what is a market and what distinguishes one place on this planet from another? And it is the sum total of the things that go into making up a community.

A direct marketer who is selling personal computers doesn't make any effort to sell them in the Amazon jungles. They sell them where the people will buy them. And why do they buy them—because the States and the localities have provided the educational structure, the road network, the physical wiring and cabling network—all of these things, which make it possible for that marketer to sell a computer.

There just isn't any market for them in the Amazon jungle, and the reason is that nothing has ever been done to create that market. Many of the things that are done to create markets are done by State and local governments.

Senator BAUCUS. Mr. Hansen?

Mr. HANSEN. I want to reinforce that the sales tax is a transaction tax. Sears has been mentioned and pays a myriad of other taxes such as the property tax, for the basic support structure. For the use of the highways physically in the State, they pay a gasoline tax. The sales tax is a transaction tax. The benefits received by a direct marketer from a sales tax, I would maintain, is very similar to the benefits received by the local marketer through the sales tax; and that is the superstructure, the delivery system, the garbage system, the road system, the mail system. So, the benefits, I feel, are the same, whether it is a local or a direct marketer.

Senator BAUCUS. One other question. I wonder if the rest of you agree with Ms. Reynolds about a lesser sales tax for local jurisdictions, that is, although it is preferable in her view that the direct seller collects the tax, and the State gives that to the local jurisdiction according to zip codes and the portion of sales that come from that certain zip code. But a lesser alternative, as I understand it, is a single collection by the direct seller and payment back to the State and the State then takes care of the allocation.

I wonder if the rest of you—although you may prefer the first alternative—would go along with the second?

Senator FARABEE. The National Conference of State Legislatures would have strong objection to the second alternative. Let me give you an example. The State of Texas has a six percent sales tax, as we indicated earlier when Senator Mitchell was in the chair. There is, in addition, a penny sales tax for the cities. It would be questionable whether it would be uniform or not, in deference to the Presi-

dent of the League, because only 99.5 percent of the cities in Texas apply it. And that is something that perhaps should be addressed; but to simply take the six percent, which it otherwise should and then go to the State, and then say we are going to take then a percentage—say 10 percent of the six percent that should be going to the State and, like revenue sharing, flow that to the cities—would create serious problems on a philosophical and governmental policy basis because Congress then would be mandating a form of revenue sharing. So, we think that by far the more preferable approach would be option one where the tax is applied. Perhaps, again, you would use some kind of a de minimis so that, if it becomes too complex, it would not be—but certainly city sales taxes would not be that difficult in the computer age.

When you get into the more esoteric things, like the Metropolitan Transit Authority or a property tax offset, that might be handled differently.

But then, finally, from a tax administrative point of view of requiring the States and the local entities to share a part of the burden—which they do in Texas—the merchant collecting the sales tax does retain a small percentage to offset those costs and to set up a clearinghouse as the National League suggested, so that the information will be readily available, simply to be put into the computer and could be called up as quickly as that shirt size that we hard about earlier.

Senator BAUCUS. Mr. Baldwin?

Mr. BALDWIN. Yes, Mr. Chairman. The draft legislation prepared by NATA suggests a uniform base and a uniform rate, and we would hope that whatever solution made its way through the Congress—assuming one does—would contain those provisions. As tax administrators, we take no position on any disposition of the money, once the States have gained it. In passing, we would simply note that the possibility that there would be Federal legislative action which would prescribe the disposition of State revenues certainly does raise some interesting issues in Federalism.

Senator BAUCUS. Thank you. Senator Mitchell?

Senator MITCHELL. Thank you very much. Several of you—Mr. Baldwin especially—commented on the unfair competitive advantage that out-of-State direct mail retailers have over in-State in the sales tax area. Do you acknowledge that there are compensating costs for out-of-State operations, such as shipping and handling, that don't exist with respect to local retailers in many cases?

Mr. BALDWIN. Yes, I would acknowledge that, Senator, but at the same time, I would also point out that there are costs incurred by local retailers to market in the fashion that they do that are not incurred by direct mailers.

Senator MITCHELL. So, the fact is that there are a large number of cost factors, some of which apply to local retailers, some of which apply to out-of-State retailers; and to single out one factor and to suggest that purchasers make their decision on the basis of that one factor, it seems to me at least, to ignore the reality of most transactions.

Mr. BALDWIN. My response to that, Senator, would be that all of those differences in the costs are things that have been by choice of

the business person. In this case, we are talking about something where there is no choice exercised.

So, if our desire, and part of our desire here in terms of the unfair competitive advantage, is the creation of a level playing field--and I think that is the more important issue—any unevenness in the playing field that has been created by the business person's own choice is not something that is appropriately a concern of ours.

Senator MITCHELL. The underlying assumption of the argument—and I am sorry that I did not hear Ms. Reynolds' testimony, so I can't comment on that—but the underlying assumption of at least the three of you and the preceding witnesses is that the so-called unfair competitive advantage is that purchasers make their decisions on the basis of that cost differential.

Now, we had a hearing on this a couple of years ago, and I don't believe anyone at that time offered any actual evidence to support that assumption. Do any of you have any evidence to substantiate the underlying assumption that purchasers of direct mail make their decisions based exclusively or even primarily on the differential created by the sales tax?

Mr. BALDWIN. I would respectfully suggest, Senator, that the evidence is found in the law of supply and demand, and price is a function of the movements of supply and demand.

Senator MITCHELL. So, the answer is no.

Mr. BALDWIN. And if you change the price——[Laughter.]

No, that isn't the answer. If you are looking for an empirical analysis which, chapter and verse, will tell you that this purchaser in this town made this purchasing choice based on the fact that they could buy it through the mail cheaper—you introduced your question by saying that that is the underlying assumption of everything that follows—I am not sure that it is.

I think that the unfair competitive advantage is one dimension of this. I think the revenue hemorrhage that we are facing as this type of retailing expands is at least of equal importance in our markets. We certainly are here in behalf of Main Street American merchants, but I think all of us have alluded to the revenue loss in our testimony before we alluded to the unfairness issue.

So, it is not the underlying assumption. It is not the driving reason why we all came to Washington today. The revenue hemorrhage is far more important.

Senator MITCHELL. Then, leaving aside the question of the importance of that factor, since this issue has now been with us for several years and since proponents of the legislation have not yet offered any, as you described it, empirical data, and as I described it, evidence, to support that assumption, would it be fair for us to conclude that there is no such evidence?

Mr. BALDWIN. No, I don't think it would be unless you can conclude that all of the sales which are made, which would include increases in direct mail marketing, and all of the sales that are made through television marketing that occur in the future, are sales that would not have otherwise occurred. You can't conclude that, and I don't think any reasonable person would conclude that. Those sales have to come from someone. Who would that someone be if it is not the Main Street American business person?

Senator MITCHELL. With all due respect, I don't think that is an answer to the question; but I accept it, and let the record stand as it may. Have either you or Mr. Hansen or others estimated the cost to you of handling and verifying the returns of thousands of out-of-State direct mail companies? And how would you effectively audit their returns? How would you enforce this as against a mail order company in Maine or California or Wisconsin?

Mr. BALDWIN. I don't think that the costs of processing returns and remittances with respect to direct mailers would be any different than for in-State vendors. And to the extent that we were adding to that burden, we would only be doing so at the extreme edge of the margin. We would audit them in the same fashion as we do other sales tax vendors, and almost all States that have sales taxes have elaborate in-State and out-of-State audit programs. We also have something which is a relatively new phenomenon, and that is an elaborate configuration of interstate information exchange agreements which would certainly contribute to the audit selection process, if nothing else.

I would not expect this to greatly increase State level administrative costs.

Mr. HANSEN. Senator Mitchell, on your prior question concerning the empirical or evidence nature, we have not endeavored to write down and make a formal survey; but I can tell you personally that, in speaking with Chambers of Commerce in the Utah area specifically—the Greater Salt Lake Chamber of Commerce—they are very willing and able to come up with a verbal response to the question of people who come into their stores and openly will take a serial number off of a television set or a computer and tell the clerk or the store owner: I am going to order this; or I can get this through the catalog, and I don't have to pay the sales tax. Now, I would say that the evidence is there.

The fact is true that we have not formally gathered it and may have to gather it, but the evidence is there.

Senator MITCHELL. All I can say, Mr. Hansen, is that we have been at this for several years. I keep asking for such evidence, and none of it is ever presented. So, it is very difficult to conclude that the evidence is there. Might there have been individual anecdotes from Portland, Maine or Salt Lake City, I don't doubt that; but surely, you would not suggest that we base national tax policy on the relation of an anecdote of that type—an unknown person said to an unidentified retailer about an unnamed piece of merchandise, how he is going to take the serial number and get it from the mail order company.

It seems to me there has to be a somewhat firmer evidentiary basis to ask the Congress to enact sweeping legislation of this type that would have an effect upon thousands of retailers and millions of employees throughout the country. So, if there is such evidence, we welcome it; and I repeat what I have said twice now. I have heard this case made for several years now. I have asked every time of people who have come here: Where is the evidence? No one ever has any evidence.

At some point, it seems to me that it is a fair conclusion for us to make that there isn't any. Thank you very much, Mr. Chairman.

Senator BAUCUS. Thank you all very much. We appreciate it. Our final panel consists of Mr. J. Con Maloney, Chairman of the Board of Cowboy Maloney Appliance and Video; and we have for the retail dealers of America, Mr. Alan Glazer, President of Bedford Fair Industries of Mount Kisco, New York, and Mr. Lucas Powe, Professor of Law at the University of Texas; Mr. Joseph Connelly, Chief Financial Officer of The Home Shopping Network in Clearwater, Florida; and Mr. William T. End, Executive Vice President of L. L. Bean in South Freeport, Maine.

I will ask the witnesses to testify in the order in which I named them. So, why don't you begin, Mr. Maloney?

STATEMENT OF J. CON MALONEY, CHAIRMAN OF THE BOARD, COWBOY MALONEY APPLIANCE AND VIDEO, JACKSON, MS, TESTIFYING ON BEHALF OF THE NATIONAL ASSOCIATION OF RETAIL DEALERS OF AMERICA, INC.

Mr. MALONEY. Mr. Chairman, I find it somewhat ironic that, in the division of the panels, there seems to be a pro and a con panel; and the only reason I can see why I ended up on the con panel is that that is my name. [Laughter.]

Because with the other gentlemen seated here, I think I am probably on a different side from them.

I do appreciate very much the opportunity to appear before you, Mr. Chairman. I am J. Con Maloney. I am Chairman of the Board of Cowboy Maloney Appliance and Video Centers, a company headquartered in Jackson, Mississippi. We operate five stores throughout the State, selling all types of home appliances, as well as audio and video equipment.

In addition, we service the products we sell. I also serve as President of the NARTA America Buying Group, a nation-wide group of approximately 120 retailers whose businesses are similar to mine, located around the country; and we purchase collectively about $1.3 billion a year in appliances. I am appearing here today on behalf of the National Association of Retail Dealers of America, Inc. We are headquartered in Lombard, Illinois.

NARDA is a national trade association which represents more than 4,000 companies which sell and service a variety of consumer products, including major appliances, consumer electronics, and related items.

We appreciate the opportunity to appear here before the subcommittee today to express NARDA's support for legislation which would authorize State governments to collect sales and use taxes from certain out-of-State sellers. Increasingly today, NARDA members like myself are competing with out-of-State sellers. Customers visit our stores, note prices and model numbers, then call toll-free to national sellers, and place their orders. Often these national sellers charge less than the prices charged by NARDA members, usually because they do not have some of the overhead expenses, such as service departments, which NARDA members must absorb.

But they gain a further advantage, Mr. Chairman, because they do not collect State sales tax. Even if the selling price of the merchandise is identical, customers can still save by not having to pay sales tax on a big ticket item.

In the case of my State of Mississippi, with its six percent sales tax, the savings can be substantial. A customer purchasing a $1,000 video camera would save $60.00 in sales tax alone. This kind of national competition hurts companies like mine in two ways. First, we lose sales because customers can avoid sales tax by buying from an out-of-State vendor. Second, if the product needs service, we are called upon to repair an item which we did not sell, often having to accept the less than market rate reimbursement provided by some manufacturers for in-warranty repair.

This national competition also hurts my State, which, incidentally, I have served for the last 16 years as a member of the State Senate. Mississippi loses a sale subject to the sales tax and also loses because an in-State company does not pay corporate income tax on that sale, and an in-State salesperson is deprived of a commission which would be subject to our State income tax.

The Advisory Commission on Intergovernmental Relations has estimated that in 1986, Mississippi lost nearly $20 million in sales tax revenues because of out-of-State selling.

In our opinion, it is time to put the competition on a level playing field. We urge the subcommittee to favorably report legislation to overturn the *National Bellas Hess* decision and permit State and local governments to require collection of sales taxes and use taxes by out-of-State sellers. There are several items which we believe should be included in any legislation reported by this subcommittee.

First, the legislation should cover both mail order and telephone sales. In addition, it should cover sales resulting from customer visits to stores when delivery is made to another State. Second, in order to minimize the paperwork burden on small businesses, the legislation should be limited to those sellers which transact a minimum amount of dollar volume sales in a particular jurisdiction.

Third, the legislation should contain provisions which make it simple for an out-of-State seller to collect and remit local sales tax which are in addition to State sales tax. Fourth, the legislation should provide for a uniform rule on the definition of where a sale actually takes place, for example, at the point of shipment or at the point of receipt; so the seller will have clear and unambiguous direction as to which sales tax to collect.

In conclusion, Mr. Chairman, NARDA urges this subcommittee to as quickly as possible report this legislation to the full committee. We realize that there may be provisions in both S. 639 and S. 1099 which need modification. We would be very pleased to work with the subcommittee staff members to ensure timely consideration of this most important legislation.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you very much, Mr. Maloney. Mr. Glazer and Mr. Powe, I believe you are allocating your five minutes together. Is that correct?

Mr. GLAZER. That is correct. We will certainly attempt to do so.

STATEMENT OF ALAN GLAZER, PRESIDENT, BEDFORD FAIR INDUSTRIES, LTD., AND MEMBER OF THE BOARD, DIRECT MARKETING ASSOCIATION, INC., MOUNT KISCO, NY

Mr. GLAZER. Good morning. My name is Alan Glazer. I am President of Bedford Fair Industries, Ltd., a direct marketing company, headquartered in Mount Kisco, New York where we employ more than 300 people.

Bedford Fair had sales of between $25 million and $35 million last year. We think we are typical of the thousands of companies that would be severely burdened by the tax collecting and record-keeping responsibilities which S. 639 and S. 1099, which would permit States to impose upon national direct marketers. I have previously submitted testimony to this committee; and rather than to read that testimony to you today, I would like to, one, abbreviate it and, two, begin to refute some of the testimony provided this morning because the fear is that, if certain numbers are repeated often enough, they will in fact become believable. In truth, they are not.

As a member of the board of directors of the Direct Marketing Association, I am testifying on behalf of more than 2,700 members which include those who would be indirectly impacted by this legislation, including printers, list brokers, mailing houses, common carriers, advertising agencies, catalogers and suppliers. We are opposed to the bills before the committee because they would unfairly burden direct marketing companies and our customers in ways not experienced by retail stores or their customers.

It is much more difficult—much more difficult—to collect the tax through the mail than it is in person; and it is certainly more difficult to compute the tax yourself, rather than to hand it to a cashier who, in fact, computes the tax for you.

Let me point out four elements, if I may, of my submitted testimony. First, Congressman Dorgan and other proponents of this legislation are now claiming that the States would gain over $2 billion in new revenues. The truth is that less than $900 million would be gained if every penny were collected at no cost to State governments and with no adverse effect on the economy or upon sales volume.

Second, tax administrators have told their governors that this is a problem that is getting larger by leaps and bounds. In fact, industry sales figures used by proponents include categories of direct marketing that are tax-neutral, such as political and charitable fund-raising efforts and sales of financial services and insurance companies. These happen to be also major growth areas in the direct marketing industry today. On top of that, major trends in direct marketing indicate that more and more companies will voluntarily be submitting to the tax jurisdiction of more and more States for good business reasons in order to set up regional distribution centers, telephone marketing centers, or retail outlets. Because of this trend, approximately 50 percent of all taxes on mail order sales are currently being collected; and that percentage is growing not shrinking today.

Third, tax administrators have told their governors that the current situation is unfair to their in-State retailers and, because mail order customers often do not pay the tax—the sales tax or the use

tax—that business is being taken away from retailers who must charge the tax. This again is not true.

Not only is there no unfair competition on the basis of sales tax, but in over 90 percent of direct marketing, there is no competition on the basis of sales tax at all. The average direct marketing sale is just over $50.00. The average direct marketing sale is not a high ticket sale amounting to hundreds and hundreds of dollars or even thousands of dollars.

Our customers do not buy, for example, a dress for $39.99 because of the presence or the absence of a sales tax. I will point out to you that in approximately 12 to 24 of the States that have a sales tax, their tax is not pertinent or relevant to women's wearing apparel. However, we do just fine in those States, and yet there is no incentive to buy from us for sales tax avoidance, evasion, or any of the other cliches that have been leveled today.

Finally, and most important of all, tax administrators have told their governors and others that collecting will really not be much of a burden to direct marketers with sales over a certain arbitrary threshold—in this case, $12.5 million. This is an assumption. No study has been done, and no inquiry has been conducted by proponents of the legislation.

Therefore, the Direct Marketing Association commissioned the firm of Touche-Ross to do on-site studies to determine the current collection costs for 30 direct marketers of various sizes. The results are summarized in my testimony.

Now, I realize it is necessary for Government officials to be skeptical of industry claims, and we welcome this skepticism. But instead of a searching cross examination and dialog, we in the industry have been confronted with a refusal to discuss the issue. Tax administrators have said, in effect, we don't believe you and we don't want to talk to you about this issue.

I suppose from a narrow perspective, that makes sense. Tax administrators want some version of the current proposal now before the committee. If the collection costs for direct marketers are anything close to the results of the Touche-Ross study, showing by the way that direct marketing costs are six times those of a retailer to collect a dollar of sales tax, then this legislation would be unthinkable.

If I may, in conclusion—and I have many other remarks, but I don't want to be unfair to the members of the committee or the other panelists here this morning—we collect tax in New York State where we are located. We have chosen to be there voluntarily. We have spent years and many, many thousands of dollars in an attempt to computerize our program to collect sales tax. As of this date, we still collect sales taxes for 82 subdivisions of the State of New York, and it is done manually. We have been unable to computerize this function over several years.

Finally, think for a moment about the issue of compliance. Are we the tax collector, or are we the taxpayer? Which will we be? When a customer forgets, refuses, or otherwise does not indicate or does not send in $2.00 of sales tax on a $39.99 dress and the tax is $2.00, we have Hobson's Choice. We either process the order and lose the five percent tax, which we must still remit to the State, or we hold up the order and write to the consumer, which I can guarantee

you costs far in excess of $2.00—to start that dialog with the customer. What we do in New York State is we pay the sales tax, regardless of whether it is remitted to us or not.

Consequently, our sales in New York State where we are located are far less profitable than our sales in any other State. That is a choice we have made, but if we are forced to remit sales taxes which we cannot collect because they are individually such small amounts, then we will lose the profits in 45 or 46 States, or in effect across the entire country.

I am the president of a modest-sized company. I have been before this committee two years ago, before the House committee this spring, and before this committee again today; and I thank you for that privilege. I devote my time to this issue because it is potentially ruinous to my business and to this industry if this legislation is passed.

It is not that we will be less profitable. It is that we are likely to stop existing. It was mentioned this morning that the average net profit of gross sales is 1.9 percent for retailers. I will suggest that for many mail order firms it is not much larger. Let's take an arbitrary number and suggest that it is three percent. If I must remit when the taxpayer does not pay me five or six percent to some foreign State, then I have immediately given up the profit of that sale; and I have incurred a loss. That certainly is not a circumstance that we can continue business under. Thank you very much.

Senator BAUCUS. Mr. Powe?

STATEMENT OF LUCAS A. POWE, JR., BERNARD J. WARD CENTENNIAL PROFESSOR OF LAW, UNIVERSITY OF TEXAS, AUSTIN, TX, TESTIFYING ON BEHALF OF THE NATIONAL MARKETING ASSOCIATION, INC.

Mr. POWE. Thank you, Mr. Chairman. As a professor of constitutional law, I find it intriguing so soon after the Bork hearings to be part of a process that questions whether the Congress should overrule a decision of the United States Supreme Court, based on constitutional issues.

Now, Senator Mitchell in a question earlier suggested that National Bellas Hess rested on the Commerce Clause, and Mr. Ross in his testimony suggested that the court might shift formal grounds from the Commerce Clause to Due Process if the Congress passes this legislation.

What is interesting is that National Bellas Hess rests on the Due Process Clause as well as the Commerce Clause. It is not something mythical about the opinion. Justice Stewart, who is noted for his sparseness in writing, specifically wrote that the tax in question as applied to National Bellas Hess violated the Due Process Clause of the 14th Amendment.

As the court has held as recently as Metropolitan Life versus Ward two years ago, the Congress lacks the substantive power to overrule Supreme Court decisions based on the 14th Amendment. Those are constitutional decisions where the court, not the Congress, decides.

Now, many of the previous witnesses have suggested one way or another that National Bellas Hess exists in sort of a 1960s time warp. Fine for that bygone era, but not part of our constitutional law today. That ignores the fact that the court has gone back to National Bellas Hess again and again. The modern test for State taxation applied in Complete Auto Transit versus Brady makes National Bellas Hess the premier point. The State may not even think about taxing unless there is a substantial nexus with the company.

And while our distinguished Senator Farabee from Texas has twice in his testimony suggested that Justice Fortas got it right in National Bellas Hess, I would note that Justice Fortas was dissenting in the case. He made the same arguments that Senator Farabee made, and they were rejected by the Supreme Court in that decision. The court did not conclude that the State's willingness to allow its citizens to buy out of State created a substantial nexus with the retailer.

Finally, in National Geographic versus the California Equalization Board, the Supreme Court was given a golden opportunity to cut back on National Bellas Hess because the California Supreme Court made it quite clear that they were going beyond National Bellas Hess and that they would accept even a minimal presence or nexus in order to apply their tax.

The Supreme Court unanimously rejected the language of the California Supreme Court. It reaffirmed a substantial nexus as defined in the court's prior cases was a requirement for State taxation.

So, while I don't have much doubt that if National Bellas Hess rested on Commerce Clause grounds alone that the issue would be one of Congressional wisdom, it does not so rest. The court was very explicit that it rests on the Due Process Clause, and the importance of the Due Process Clause is that it applies a bright line rule so that people can know which side they are on for jurisdictional purposes.

Because it so rests, the Congress lacks the power to overrule that decision. Thank you, sir.

Senator BAUCUS. Thank you, Mr. Powe. The next witness is Mr. Connelly.

STATEMENT OF JOSEPH A. CONNELLY, CHIEF FINANCIAL OFFICER, THE HOME SHOPPING NETWORK, CLEARWATER, FL, ACCOMPANIED BY JOSEPH REILLY, OFFICER IN CHARGE AND DIRECTOR, TAX DIVISION, HOME SHOPPING NETWORK

Mr. CONNELLY. Thank you, Chairman Baucus and members of the subcommittee. I am Joseph Connelly, Chief Financial Officer and Chairman of the Executive Committee and a Director of Home Shopping Network, the largest electronic marketing enterprise in the country. With me today on my right is R. Joseph Reilly, Officer in Charge and a Director of HSN's Tax Division. On behalf of HSN, I would like to thank you for this, our first opportunity to testify before the United States Congress.

I will be presenting testimony in opposition to S. 639 and S. 1099, The Equity and Interstate Competition Act of 1987, legislation cur-

rently pending before the Subcommittee on Taxation and Debt Management.

Before I begin my testimony, let me take a moment to describe our electronic marketing operation. In 1982 from the Tampa Bay area of Florida, HSN began satellite cable transmission of live customer interactive product sales programs. Today, HSN transmits programming 24 hours a day, seven days a week to cable television systems, satellite dish receivers, affiliated television broadcast stations, and UHF television broadcast stations. As of September 1, 1987, HSN reached 43 million homes and 2.6 million consumers became Home Shopping Club members by purchasing televised products.

HSN provides consumers with the unique mix of television entertainment and product availability. St. Petersburg, Florida is the home for HSN's new telecommunications center where customer orders are taken by phone and transferred to a distribution center for processing. Various wholly owned subsidiaries of HSN own broadcast facilities in California, Florida, Illinois, Maryland, Massachusetts, New Jersey, New York, Ohio, Oregon, and Texas.

Additionally, HSN maintains distribution facilities in Florida, Virginia, Iowa, and Nevada.

During the fiscal year ended August 31, 1987, HSN paid $19 million in Federal income taxes and $1.2 million in State income taxes. Home Shopping Network is opposed to State legislative efforts, S. 639 and S. 1099, to give States the authorities to require out-of-State vendors to collect and remit State sales taxes.

HSN operates in accordance with the National Bellas Hess Supreme Court decision, which ruled that a company must have sufficient business nexus in a State before that State can require the company to collect State sales tax on the State's behalf. S. 1099 attempts to overturn the National Bellas Hess decision by giving State jurisdiction over those companies which engage in regular or systematic solicitation of sales in the State and have gross receipts of $12.5 million nation wide or $.5 million State-wide.

It is our position that neither regular solicitation of sales, be it televised or other advertising media, nor gross receipts quotas constitute a sufficient business nexus in a State because the State is not providing services to the company; and therefore, the State has no jurisdiction over the company. Accordingly, HSN collects and remits sales tax to each State in which it maintains facilities.

In the fiscal year ending 1987, HSN remitted over $17.2 million in sales taxes to the nine States that I mentioned before that house our facilities during the year.

HSN does not agree with the arguments of State tax administrators who claim that their States are losing tax revenue because of the growth of the electronic marketing industry. States levy sales and use taxes on citizens to bring needed revenue to the State. Based on past tax collections, the State adjusts its sales tax to meet the fiscal needs of the State. If the State never receives sales taxes nor delivered services requiring State expenditures, how can tax administrators calculate a loss of revenue to their States? Sales taxes are collected in order to maintain local and State services, such as police and fire protection, upkeep of State roads and facilities

We disagree with the concept that States could mandate the collection of use taxes on products which never required State services while maintained by HSN. Furthermore, out of State vendors would be deprived of the right of representation and would not have a voice in the State legislative process which crafts collection and remittance of procedures for sales taxes.

Another argument made by States is that the uniform collection of State sales taxes by both in-State and out-of-State vendors would create a level playing field in the industry. To the contrary, we at HSN believe that the result of S. 639 and S. 1099 is that an unfair burden would be placed on the out-of-State vendor, as well as his customers.

State laws vary with regard to what items are subject to sales and use taxes. For example, some States tax clothing while others do not. Some States tax handling charges, but there are also exceptions. Even with one of the most sophisticated computer systems in the industry, HSN anticipates that the task of programming and monitoring 41 additional State tax laws will be a nightmare.

Additionally, customers will continue to pay differing sales tax rates to in-State and out-of-State vendors. At any given time, the local tax could vary substantially from the tax being charged by the out-of-State vendor. Therefore, the level playing field can never be accomplished; and while out-of-State vendors incur the excessive costs of implementing Federal legislation, in-State vendors continue to collect sales taxes, unburdened at the cash register.

We feel strongly that, rather than having a competitive advantage or disadvantage with in-State vendors, HSN is an innovator in the marketing of products. As stated earlier, HSN provides both entertainment and the opportunity to purchase merchandise. Products are displayed one at a time, based on availability; and viewers are invited to call in to the show and ask questions or make comments about the merchandise. HSN does not provide viewers with a "TV guide" of what items will be available on any given day or time.

The average HSN viewer is 45 years of age, a professional with an average income of $38,000 a year, and a healthy majority—72 percent—of HSN viewers are women. Simply put, our HSN viewers are not sitting at home avoiding the retail stores with their sales taxes, hoping that the item that they need or want will appear next on the television screen.

Senator BAUCUS. I will have to ask you to summarize your testimony, Mr. Connelly. Wrap it up, please.

Mr. CONNELLY. Sure. In essence, what we are trying to say is that the person looking at our program will probably go to the retail store to touch and feel something similar to it. In addition, they will probably purchase another item before they leave the retail store.

We would urge the retail vendors to look at the large discount chains before they look at TV because they are not going to go shop and come back and watch TV for three or four days before an item comes on the air. Thank you.

Senator BAUCUS. Thank you. Mr. End, you appropriately have the last word. [Laughter.]

STATEMENT OF WILLIAM T. END, EXECUTIVE VICE PRESIDENT AND SENIOR VICE PRESIDENT OF MARKETING, L.L. BEAN, INC., SOUTH FREEPORT, ME

Mr. END. Thank you very much. Good morning. My name is William T. End, and I am the Executive Vice President of the mail order firm in Maine, L.L. Bean, Inc. Both the company and I appreciate the opportunity to provide testimony regarding S. 639 and S. 1099, both of which are before the subcommittee this morning.

L.L. Bean is a mail order retailer of outdoor equipment, clothing, and sporting goods. L.L. Bean is celebrating its 75th year of existence this year and was founded in 1912 by an avid hunter and outdoorsman, Leon Leonwood Bean. Mr. Bean's descendants continue to own the controlling interest of the company. Today, L.L. Bean distributes more than 75 million catalogs annually to customers in all the 50 States and in many foreign countries.

We have sales in excess of $300 million a year, and we employ over 2,200 individuals. L.L. Bean has only one retail store which has always been located in Freeport, Maine. All of our manufacturing, distribution, and other facilities are located within the State of Maine. Although Freeport, Maine may be remote from many of the major consumer markets in the U.S., this country's postal system, telecommunications network, and transportation facilities allowed us to reach a national market for our products.

The purpose of my testimony this morning is to provide this subcommittee with a direct marketer's ground level view of the burdens and inequities which the proposed legislation presents. The proposed legislation places a relatively heavy burden on mail order retailers who, in turn, receive none of the benefits resulting from the collection of sales tax.

For a point of sale retailer, collection of sales tax is a relatively easy matter. The tax is simply added to the sale price of the product being sold and collected at the register. Sales personnel need consider the rules of only one State. Consequently, there is no confusion over the applicable tax rates, which items are exempt from the tax, or how the tax should be accounted for and remitted to the State treasury.

A mail order company, such as L.L. Bean, however, would incur substantial additional costs in complying with the tax laws of 46 separate jurisdictions. First, a mail order retailer, such as L.L. Bean, would have to advise its customers of the tax rates and exemptions for each of 46 taxing jurisdictions. The only way L.L. Bean has for providing this information is in its catalog. We would have to include a complicated set of instructions setting forth rates and exemptions for the various States.

L.L. Bean has estimated that devoting the catalog space to explain the sales tax rates and exemptions for 46 taxing jurisdictions would have a direct cost in 1987 of $950,000 to the company and an opportunity cost of $9.5 million in lost sales. Furthermore, we would be presenting our customers with complicated information. The success of direct marketing depends heavily upon making the transaction as simple as possible.

Once we make mail order complex and confusing for our customers, we discourage their doing business with us.

Second, all State sales tax laws provide that, if a retailer responsible for collecting the tax from its customers fails to do so, the retailer itself is responsible for payment of the tax. The shopkeeper simply collects the tax at the cash register; it is not faced with post-sales collection problems. This would not be the case, however, for L.L. Bean.

Last year, two million of our customers paid for their purchases by personal check. Under the proposed legislation, if customers did not include the sales tax with their payment, or if they improperly computed the tax, L.L. Bean would either have to refuse to deliver the product ordered, pay the tax itself, or attempt to collect the tax after we have shipped the goods. These post-sales collection efforts would run into hundreds of thousands of dollars.

In many instances, the administrative costs of collecting the tax would be greater than the tax itself.

Third, under the proposed legislation, a direct marketer would have to contend with the use tax laws of 45 different States plus the District of Columbia. L.L. Bean, for example, would be subject to 46 possibly different tax rates, 46 separate sets of exemptions, 46 methods of remittance, 46 different timetables for remittance, 46 different auditing procedures, and 46 different audit visits.

L.L. Bean has no connection with California, other than the fact that it sells merchandise to residents there. It has been provided no services by California and realizes no benefit from the expenditure of State revenue. S. 1099, however, would require us to become tax collection agents for California as well as 45 other jurisdictions, although we are not doing business there and neither receive nor become eligible for the services which these governments customarily provide to their in-State retailers.

These government services include police and fire protection, maintenance of highways, job training programs for employees. We do not take lightly the concerns of the many State tax administrators for finding new sources of tax revenue. The problem with this legislation, however, is that it imposes disproportionately heavy administrative demands on mail order companies when compared to the efforts required of in-State retailers. It should be remembered that the State sales or use tax is imposed on the customer, not on the out-of-State vendor. Nonetheless, the proposed legislation would impose difficult and damaging burdens on mail order retailers. The harm and expense to the industry should be carefully considered before imposing this duty.

S. 1099 does not eliminate the confusion and disparities resulting from 46 different tax jurisdictions. The equities in the legislation might be different if the States were proposing a uniform sales tax on all mail order sales, a uniform set of exemptions, a uniform and centralized system of reporting, remittance, and audit procedures.

L.L. Bean has sought to comply with and has followed every applicable Federal and State regulation. L.L. Bean collects and remits Maine's sales tax. We are very much troubled by S. 1099 and S. 639 because they would place a heavy burden in costs on us to act as an agent of distant States where we have no connection and realize no benefits.

L.L. Bean is not the kind of company that frequently voices opposition to pending legislation. These bills, however, would have such

a major impact on the way we do business that we felt it important to make our concerns known today. Thank you for giving me the opportunity to testify here this morning.

Senator BAUCUS. Thank you, Mr. End.

Senator BAUCUS. The panel that preceded yours at some length explained that they thought the nexus was—that is, what benefits they saw that States provide to direct mail firms. I think it was the council member from Denver particularly who mentioned that, as a council member, she has got to worry about trash disposal of all the catalogs.

I think you, Mr. End, said that L.L. Bean sends out 75 million catalogs, and that is just one firm. Frankly, Ms. Reynolds had some impact on me because every Monday and Thursday evening I take out the trash at our house; and I am astounded at the amount of paper that I take out. A lot of it is newspapers—the Washington Post, the New York Times, etcetera—but a lot of it is catalogs. I am astounded at the amount of catalogs in that trash bag when I take it out to the curb.

That is trash that has got to be carried away, and I am not the only one who gets catalogs. I was just wondering, Mr. End, because you said you got absolutely no benefits; and it seems to me that States are providing some benefits. That is, trash disposal is one. L.L. Bean doesn't send trash trucks around the country to pick up its catalogs.

Another benefit is the roads for carrying the trash away or for delivering the product, for example. L.L. Bean doesn't send contractors out to build roads in the States to carry the products or to carry the catalogs. It just seems to me that there are some benefits that States do provide to direct mail order firms. I wonder if you could comment on that?

Mr. END. Sure. First, I hope you are saving our catalog, but—— [Laughter.]

Senator BAUCUS. We get your catalog, too. [Laughter.]

Mr. END. Basically, I think it is a question of degree. I think the trash is an example perhaps of one where there is some related benefit. I think as it relates to roads, we do a substantial amount of volume with UPS and USPS and other companies. They are all paying taxes in those States where they are working. I think it is also a question of degree when you take into account police, fire, roads, schools, job training, and things of that nature where a retailer, which L.L. Bean is one, does benefit substantially by being in that State.

I think the question of degree is what we are talking about here, and clearly, for the most part, L.L. Bean benefits very, very slightly if at all from a State like California which we would be asked to collect the sales tax.

Senator BAUCUS. Can any of you come up with any compromises here? The fact of the matter is that there are good arguments on both sides; and when that happens, the best solution generally is some kind of resolution.

What kinds of resolutions do any of you have?

Mr. MALONEY. Mr. Chairman, I think that there is a question as to who is paying the taxes. I think that Mr. End made the point very succinctly when he said the consumer pays the taxes, and the

consumer is the person who resides in the area that provides the services. The major problem is the difficulty in collecting the taxes.

Now, I have the L.L. Bean catalog, and I am going to continue to order from them because I like their products. They are unique. There are other people who do not sell unique products, but they merchandise uniquely, as was stated. And I would hope that perhaps there could be some way where the States might participate and come back to the individuals, as to many States nowadays, and allow them some portion of what they collect as a compensation for their collection.

Now, frankly, in my State it doesn't cover nearly my cost, but it is something there. And if all States that wanted to participate in this, if there was a regulation that was set that they would compensate back some small amount.

And then, if in fact—as these gentlemen have pointed out that they don't think the tax is a real factor—I think it is; but if it is not, then we will all again be playing closer to that level playing field. So, there may be some way to work it out; but the bottom line to me, Mr. Chairman, is that the person actually paying the tax is the consumer, not the person who is doing the selling. We are simply the collectors.

Senator BAUCUS. Now, gentlemen, Mr. Maloney has made a peace offering here. He has a suggestion from the State's side. Now, what offering do you have as direct sellers?

Mr. GLAZER. If I may, Senator? There has been discussion before that in some cases, from some tax administrators, that they would be willing to partially offset the cost. Some States point out that they give back about a half percent of the tax collected, maybe three quarters of a percent to the retailers who collect the tax.

I would submit, per my earlier example, that where I am forced as the taxpayer to remit $2.00 on a transaction where the customer didn't, I would find it less than generous that I might get a half percent back or even one percent of my $2.00 or that I might have the use of my own money for three months before I can submit it to the particular State.

I don't find that much of a peace offering.

Senator BAUCUS. What peace offering do you have?

Mr. GLAZER. I said in my written testimony that if it could be done painlessly and at no greater cost than to a retailer, we wouldn't be here today. We don't know how to accomplish this and to be equitable to all parties concerned. If we could, it would be much easier to go ahead and do it.

The number of exemptions within States is a problem. It has been suggested, for example, that there be something akin to a national sales tax that the Federal Government collected and remitted to the States based on some formula. How do you have a mail order company collect a sales tax on wearing apparel when well over a dozen States don't tax wearing apparel? Is that a level playing field where retailers would not have to collect the sales tax but the State would? And so, the examples go.

It is an extremely complicated issue, but we are willing to sit down, I think, and talk; but I don't know that in our searching that we have been able to come up with anything that would be workable. For example, it would sound preposterous if I were to suggest

to you, in the name of a level playing field, that a retailer be prohibited from collecting the sales tax and, after the transaction is completed, he bill the customer for the $2.00, that he collect the tax, and that he then remit it to his own State. Isn't that a level playing field? It is absurd, but wouldn't that be level? Why should he have the privilege of collecting it at the time of the transaction and when he is face to face?

If it is so easy to collect something through the mail in small dollar amounts, then I don't know why we don't level the playing field and have retailers play by the same rules.

Senator BAUCUS. Mr. End?

Mr. END. Mr. Baucus, I have three suggestions. The first one would be an effort on behalf of the States to attempt to collect the tax themselves through the State income tax form. There was a comment made earlier that one line was put on the Utah tax form, and they collected $100,000. I believe this is a more complex issue than that.

I believe it would take a full page on the State income tax form; but if you could estimate the amount of mail order buying by various income brackets for a light, medium, and heavy mail order shopper, and ask for voluntary compliance—which is the way the income tax system works—I believe they would at least have a chance of collecting a significant portion of what is reported to be $1.5 billion worth of tax revenue. I believe it is their responsibility to a much greater degree than it is a mail order company's responsibility to collect that use tax; and that is one vehicle they could approach.

The second suggestion would be that there be a nation-wide uniform tax so that the collection process would not be as burdensome as we have talked about. The testimony you have before you from the Touche-Ross company estimated that 15 cents of every dollar collected by a mail order company would be spent in administration costs to collect that. A uniform tax would dramatically reduce that. It would certainly make our concerns about the legislation less strong.

Also, a uniform tax rate on mail order customers, uniform exemptions, uniform reporting and audit procedures would certainly make life much easier for all of us.

Lastly, I think an important point is that the tax is not on us. If we make a good faith effort and spend a full page in the catalog, or two pages, to explain the sales tax collection process and the customer does not, in fact, choose to pay it, we should not be held liable for that. That good faith effort, I believe, is what is required here; and just to give you an example: A $500 million company with a five percent sales tax would collect $25 million in tax. If only four percent of the people chose not to pay, that is $1 million coming right off the bottom line of that company—a very, very substantial figure.

The numbers we have talked about this morning of $950,000 in catalog costs, those are real costs for paper, printing, and postage. Having to remit and pay sales tax where someone else has chosen not to pay could be a very substantial number.

The cost to develop the data processing systems to operate this would be very substantial, and the cost to go out and try to collect

a $2.00 sales tax on a $50.00 item—the cost of going after that—would be substantially greater than the tax raised. So, there are a number of suggestions that I believe would help make this legislation less negative, at least for L. L. Bean. Thank you.

Senator BAUCUS. Thank you. One other final question from me. I forgot whose testimony it was, but when I was going over it this morning, someone suggested there already is computer software available to meet this problem. There is some outfit named Vertex or something like that. Have any of you looked into the availability of potential software for this? Mr. Glazer?

Mr. GLAZER. I am unaware of any existing software, and I would suggest, based on previous purchases of computer software, that no reputable company would provide me with a "hold harmless," suggesting that if their software failed and I incurred the liability for taxes that they would step in and take my place. I don't know that it exists, and it would have to be capable of working with a number of computer software programs that thousands of catalog companies and other direct marketers employ at this time.

I would be skeptical that it exists at this time. Additionally, I might point out that in the area of women's wearing apparel or any wearing apparel, returns are a significant part of sales; and the tracking of small dollar amounts on the outgoing shipping of the product and then keeping track of whether or not that product or some portion of that product was returned, and did the customer initially pay the sales tax, or did I—as Bedford Fair Industries—assume the tax burden, we might find ourselves in a situation where a customer who didn't pay the sales tax and we remitted it, we would nonetheless be refunding the full purchase price of the garment plus the sales tax, which the customer did not remit in the first place.

I think that my colleague, Mr. Levering, who represents the Direct Marketing Association, has a viewpoint on the computer software issue.

Mr. LEVERING. If I might, Mr. Chairman? As you might expect, sellers of such computer software come to DMA because they are hoping to find a market for their wares; and in fact, there is a small market for them right now. However, I can say, after talking to the presidents of these companies, that they do not have the kind of computer software that would help with this Federal legislation. What they do have is——

Senator BAUCUS. It is not law. I would assume they wouldn't have it; it is not law.

Mr. LEVERING. That is true, although they might have it, anyway. Let me explain. What they have is a breakdown by counties and zip code districts so that you can get the local taxes. The problem we heard earlier with regard to the county taxes, if you were selling, let's say, just gold coins or something like that, then you could rent their software or you could buy their software for a hefty price. You would not have to program a lot of the separate items; you would just have one item, and you could fairly easily then calculate by where you are sending the product what the tax is, even down to the county level. So, it is a very valuable program for people who need to collect the county taxes.

With regard to the State taxes, of course, that problem doesn't really exist with regard to at least S. 1099. The real problem for direct marketers is the nonpayment and also the exemptions. And there is no program for the exemptions right now, plus even if you had a program—and as you said, there might be one developed in the future—you would have to separately itemize and program each of your maybe 100 to 120 items in your catalog for each State so that the State would know whether this was an apparel item or a luxury item, or if it is sold for children or if it is sold for sportswear, back and forth for each State as the distinctions go.

Senator BAUCUS. Thank you very much, Mr. Levering. Senator Mitchell?

Senator MITCHELL. Mr. Chairman, I just have one question, pursuing the line of inquiry that I engaged in with the previous panel on the question of the extent to which this price differential caused by the applicability of the sales tax is the decisive factor in consumer purchases.

Do any of you in the business have any evidence that the per capita volume of sales is higher in States without sales tax as opposed to those that do have the sales tax, or that among the majority of States that do have a sales tax that the amount of the tax influences purchases? Mr. End?

Mr. END. Senator Mitchell, we have no information on that, but I think it is extremely important to remember that, in most mail order operations, you are charged postage and handling; and that generally is in excess of five percent on an order, which puts you on equal footing with the person on the sales tax. My personal opinion as a marketer is that the sales tax issue is not a significant issue at all in the purchasing for mail order companies. There are far more important things; there is the question of uniqueness of product, ease of shopping at home, convenience of shopping at home, good customer service, the hassle of retail shopping and going into a center city and finding a parking spot, going into a store, facing sales clerks who oftentimes do not know as much about the product as is presented in the catalog.

I think there is far greater competition on those types of issues than there is on purely price. In the retail area, you have discount stores. You have high-priced department stores. And I think all of them can be successful if they do what they do very well. And I think a difference like the sales tax issue is not a significant factor in this type of buying, in my opinion. Thank you.

Senator MITCHELL. Mr. Glazer?

Mr. GLAZER. Recently, the Direct Marketing Association conducted six hours of focus groups with consumers in effect to try and understand why consumers buy through the mail or via the telephone and so on. In my recollection, I don't believe in those group sessions that there was one mention of sales tax or the need not to pay sales tax as a reason for buying through the mail. It was not an in-depth statistical study, but if it was on the top of their mind, I think in six hours we would have heard about it.

Senator MITCHELL. Thank you very much, gentlemen. Thank you, Mr. Chairman.

Senator BAUCUS. I have no further questions. Thank you all very much. The hearing is adjourned.

[Whereupon, at 11:55 a.m., the hearing was adjourned.]

STATEMENT OF THE HONORABLE JOHN C. STENNIS

ON

S. 1099, THE EQUITY IN INTERSTATE COMPETITION ACT OF 1987

Mr. Chairman, I thank you and the committee for the fine job they have done in organizing and holding these hearings on S. 1099. I feel that this bill will be an important and useful piece of legislation for all state governments.

S. 1099 would restore to the states the ability to collect sales tax from interstate transactions. This is a power the states had until the 1967 Bellas Hess case. At that time the Supreme Court struck down an Illinois law which collected a sales tax from out-of-state vendors who sold their products through the mail.

This decision has resulted in a significant loss of revenue for the states. The poorer states, such as my own, have suffered the greatest loss. It has been estimated that the inability to

tax mail order sales costs the state of Mississippi $50 million annually. This is money that we can not afford to lose. If the current trends continue, interstate sales will soon make up 20-25 percent of all retail sales and revenue losses will be even greater than they are now.

I recognize that constitutional issues have been raised against an interstate sales tax. I am confident that the final version of this bill will resolve these problems in a way that is fair to everyone involved. I am also sure that ways can be found which will enable the tax to be collected quickly, efficiently, and fairly for all parties concerned.

I thank the Chairman and the committee for the chance to express my views on this matter. I know that they will give this important piece of legislation the attention that it deserves, and I ask for its favorable consideration.

STATEMENT OF
DENNIS E. ROSS
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to present the views of the Treasury Department on S. 639 and S. 1099, each of which is intended to expand the power of State and local governments to require out-of-state retailers to collect sales and use taxes on interstate sales. These bills would reverse a 1967 Supreme Court decision, National Bellas Hess, which held that the Commerce Clause of the Constitution prevents a State from requiring tax collection by a retailer whose only connection with the State is to advertise and deliver its products by mail or common carrier in the State.

S. 639 and S. 1099 are similar to H.R. 1242, which was introduced in the House of Representatives earlier this year, and which is also designed to expand the power of the States to collect sales taxes on interstate sales. When the Treasury Department testified on H.R. 1242 before the House Ways and Means Subcommittee on Select Revenue Measures in May of this year, we expressed strong opposition to a provision contained in that bill that would involve the Internal Revenue Service in the enforcement of State sales taxes through Federal information reporting of interstate sales. We are pleased to note that neither S. 639 nor S. 1099 contains such a provision.

Background

State sales taxes are generally single rate ad valorem taxes imposed on a broad range of personal property sold at retail within the State. Many States provide exemptions for certain types of property, including, for example, food, clothing, household fuel, medical supplies, automobiles, and industrial machinery. In some States, the general sales tax also applies to the provision of services, although there is considerable variation as to the types of services covered. Forty-five States and the District of Columbia levy sales taxes, with rates ranging from 3 percent to 7-1/2 percent. In addition, sales taxes are imposed by over 6,000 local governments.

The sales tax is the second most important source of State revenues, exceeded only by the combined corporate and personal income tax. In 1986, for example, revenues from sales taxes were nearly $75 billion, and represented over 30 percent of all State tax revenues, with the percentage in individual States ranging from 20 percent to 60 percent. See U.S. Department of Commerce, Bureau of the Census, State Government Tax Collections in 1986 (1987).

In addition to differences in the tax rate and tax base, the legal form of sales taxes varies among the different States. In most States, the sales tax is imposed directly on each retail sale, the base of the tax is the selling price of the taxable item, and vendors are legally liable for collecting the tax. In other States, the legal form of the sales tax is an occupation or privilege tax imposed on retail vendors, the base of which is measured by the gross receipts of the vendor. Whether the sales tax has the legal form of a retail sales tax or a privilege tax, the tax is generally passed on to the consumer and separately stated as part of the purchase price. In fact, many States require that the sales tax be separately stated.1/ With enactment of the Tax Reform Act of 1986, effective for 1987, the itemized deduction for State and local sales taxes for Federal income tax purposes has been repealed.

States that impose sales taxes generally also impose so-called compensating use taxes on the storage, use or consumption of tangible personal property that would be subject to the State sales tax but for the fact that the property was purchased outside the taxing State. In some States, the use tax is limited to property "purchased for use" within the State and does not apply to property initially used outside the taxing State and subsequently brought into the taxing State. In other States, the use tax may be imposed on used property brought into the taxing State, although the tax base is then usually reduced to the depreciated value of the property. Many States do not apply the use tax to property (whether or not previously used) which is brought into the taxing State after a prescribed period of time after purchase, such as ninety days or six months. With certain exceptions, a credit against the use tax is available in the event that sales tax was paid on the property in another State. As with sales taxes, the itemized deduction for compensating use taxes is no longer allowable for Federal income tax purposes, effective for 1987.

Generally, the State in which a vendor conducts its business operations does not impose its sales tax on property delivered outside the State to residents of another State. Such property would be subject to the sales or use tax imposed by the State in which the consumer resides, with the out-of-state vendor usually required to register, collect and remit the tax on sales to residents of the taxing State. If no out-of-state vendor has collected the sales or use tax of the taxing State, the consumer who brings the taxable property into the taxing State is liable for payment of the use tax. As a practical matter, however, States are generally unable to collect use taxes from individual consumers.

State taxation of interstate commercial transactions and nonresident persons is subject to Federal constitutional limitations. Specifically, under judicial decisions based on the Commerce Clause or, alternatively, on the Due Process Clause of the Fourteenth Amendment, State taxation that falls on interstate commerce or nonresident persons violates the Constitution if the object of taxation does not benefit from State governmental activities. Thus, out-of-state vendors may be required to register, collect and remit another State's sales or use tax, with respect to sales to residents of the taxing State, only if the out-of-state vendors have sufficient business contacts, or nexus, with the taxing State.

It is well-settled that vendors who maintain a place of business within a taxing State may be required to collect the taxing State's sales or use tax with respect to mail-order sales to residents of the taxing State, even if such sales have no connection with a vendor's place of business in the taxing State. See National Geographic Society v. Board of Equalization, 430 U.S. 551 (1977); Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941); and Nelson v. Montgomery Ward and Co., 312 U.S. 373 (1941). Moreover, even if an out-of-state vendor has no regular place of business in a taxing State, States may constitutionally require collection of their sales or use taxes if the vendor solicits sales through agents or independent contractors located in the taxing State who are paid on a commission basis. Scripto, Inc.v. Carson, 362 U.S. 207 (1960).

In the leading case of National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967), however, the Supreme Court ruled unconstitutional a State's imposition of a duty of use tax collection upon an out-of-state mail order retailer who advertised in the taxing State only through mailed catalogues and circulars and delivered ordered products in the taxing State by common carrier. The Supreme Court held that the retailer's limited business contacts were an insufficient nexus with the taxing State and, therefore,

that imposition on the out-of-state retailer of the requirement to collect the State use tax was an unreasonable burden on interstate commerce in violation of the Commerce Clause.

Under current law, States that impose sales and use taxes have an understandable concern that there is no effective mechanism for collecting such taxes on the purchase of goods from an out-of-state vendor. As noted earlier, States cannot legally require the out-of-state vendors to collect the tax, and enforcement against individual consumers is impractical, except where there is independent verification of consumption of out-of-state purchases (e.g., State registration of automobiles or other assets). Some estimates of the lost sales and use taxes on interstate mail order sales are in the range of $1.5 billion per year. This revenue loss could be expected to grow as mail order sales increase as a percentage of total retail sales. See Congressional Quarterly at 2571-72 (Dec. 7, 1985). Beyond the issue of lost revenue, State officials are concerned that current law places retailers who must collect State taxes at a disadvantage compared to their competitors who are not required to do so.

S. 639 and S. 1099

Based on Congress' authority under the Commerce Clause to regulate interstate commerce, both S. 639 and S. 1099 are designed to expand the power of the States to impose sales or use tax collection obligations on out-of-state retailers. S. 1099 provides that a State shall have the power to require a person to collect a State sales tax imposed with respect to the sale of tangible personal property if the destination of sale -- whether delivered to the purchaser by common carrier, mail or any other means -- is in the State, and certain other conditions are met. First, the seller must engage in "regular or systematic soliciting of sales in" the State. Second, the seller must have annual gross receipts from the sale of such tangible personal property that exceed $12.5 million per year nationwide, or, alternatively, exceed $500,000 per year in the taxing State. For this purpose annual gross receipts are determined using the one-year period ending on the September 30th preceding the calendar year in which the sale subject to the tax occurs. The bill defines soliciting of sales as making known that a kind of tangible personal property is for sale.

S. 1099 would apply to sales taxes imposed by a local government only if all local jurisdictions of that type in the State impose and collect a sales tax with respect to the sale of that kind of tangible personal property, and do so at the same rate. In order for S. 1099 to apply, the local sales tax must be collected and administered by the State government, and the State may not require sellers to account for tax receipts on the basis of the geographical location of the sale. Finally, S. 1099 provides that a State may require filing of returns and payment of tax under the authority of the bill no more often than quarterly. Apart from these restrictions, S. 1099 provides that any person required to collect a State's sales tax is to be subject to all of the State's laws relating to the sales tax.

S. 639 provides that any State, or any political subdivision thereof, shall have the power to impose a sales or use tax on (1) any interstate sale of tangible personal property by a person located outside such State or political subdivision, or (2) the use of tangible personal property in such State or political subdivision acquired through any interstate sale by a resident of such State or political subdivision from such a person.2/ The bill defines interstate sale as a sale in which tangible personal property is shipped or delivered by common carrier or the U.S. Postal Service to a purchaser in a State from a point outside such State.

Discussion

Although S. 639 and S. 1099 are each designed to authorize States to require collection of sales and use taxes on interstate sales, the bills have several important differences. First, S. 639 would not require that there be any minimum contacts or nexus between an out-of-state retailer and a State other than the making of a sale into the State. In contrast, S. 1099 would give States the power to require a seller to collect sales tax on a sale of tangible personal property into the State only if the seller engages in "regular or systematic soliciting" of sales in the State.

It should be noted that H.R. 1242 would require an out-of-state retailer to have a more substantial nexus with the taxing State than either S. 1099 or S. 639. In fact, it is not clear whether the nexus required by H.R. 1242 is less than the nexus required by the National Bellas Hess case. In other words, it is possible that H.R. 1242 would merely authorize the States to do what they are already able to do under current law. The same is not true of either S. 1099 or S. 639.

A second difference between these two bills is that S. 1099 would not apply to small retailers; it would authorize a State to require collection of its sales taxes only from sellers who have annual gross receipts from the sale of tangible personal property in the United States of at least $12.5 million or, alternatively, annual gross receipts of at least $500,000 from sales in that State. In contrast, S. 639 provides no such threshold and would apply to all out-of-state retailers, regardless of size.

A third difference relates to local sales taxes. S. 1099 would allow a State to require collection of local sales taxes on sales of a particular kind of property only if the tax is the same across the State and also is collected and administered by the State. In contrast, S. 639 would authorize local jurisdictions to impose local sales and use taxes on interstate sales. Thus, under S. 639, an interstate retailer may be required to keep track of sales and use taxes for each different local jurisdiction into which it sells. In addition, a retailer may be required to face the reporting and audit requirements of a number of different local jurisdictions, as well as different States.

A fourth difference is that S. 1099 attempts to limit the compliance burden on interstate retailers by limiting the number and frequency of tax returns that may be required by a State. S. 639 does not provide any such limits.

We are pleased to note that, in contrast to H.R. 1242, neither S. 639 nor S. 1099 would involve the Internal Revenue Service in the enforcement of State sales taxes through Federal information reporting. Treasury strongly opposes this aspect of of H.R. 1242.

As between S. 639 and S. 1099, the Treasury Department prefers the approach taken in S. 1099. We believe S. 639 would impose unreasonable compliance burdens on out-of-State vendors by failing to exempt small retailers and by failing to limit liability with respect to local as opposed to State sales taxes.

Although the Treasury Department does not view S. 639 or S. 1099 as raising significant Federal tax policy issues, I would like to express a general concern regarding the bills. It is not clear that either of these bills would resolve fully the constitutional issues that prevent States from requiring out-of-state vendors to collect sales and use taxes. As explained earlier, two different constitutional provisions limit the States' authority with respect to out-of-state vendors: the Commerce Clause and the Due Process Clause of the Fourteenth Amendment. Although each of these limitations on State authority focuses on the same issue -- the taxing State's nexus with the out-of-state vendor -- they are independent legal barriers.

Although S. 639 and S. 1099 would likely clarify the scope of Commerce Clause limitations on States' authority with respect to out-of-state vendors, we are concerned that neither bill would

resolve the analogous issues arising under the Due Process Clause. The Commerce Clause vests Congress with exclusive authority to make laws respecting interstate trade, and thus Congress may be able to prescribe Federal standards for the requisite business nexus to support State imposition of sales and use tax collection obligations. The Due Process Clause of the Fourteenth Amendment, however, does not vest Congress with similar authority to establish minimum standards of due process. As a consequence, it is not clear that Federal legislation prescribing minimum nexus requirements would affect the otherwise applicable limitations of the Due Process Clause.3/

We do not express an opinion as to whether a challenge on due process grounds to the expansion of State taxing power authorized by S. 639 or S. 1099 would succeed, or as to the broader issue of the constitutional limits of congressional power over State taxes affecting interstate commerce. Legal arguments exist on both sides of this issue. One commentator recently argued that the Due Process Clause should not prevent Federal legislation of this type, but acknowledged the uncertainty surrounding the issue. Hartman, "Collection of the Use Tax on Out-of-State Mail-Order Sales," 39 Vand. L. Rev. 993, 1022-28 (1986). We only suggest that enactment of either S. 639 or S. 1099 would not necessarily settle the constitutional issues surrounding the reach of State sales and use taxes.

Before closing, I want to point out a potential international relations problem that may arise if either of these bills is enacted. Foreign governments might regard efforts to require foreign retailers to collect sales or use tax on shipments into a State as an objectionable extraterritorial extension of U.S. taxation (although a collection requirement could be imposed in a manner consistent with our obligations under the General Agreement on Tariffs and Trade).

This concludes my prepared remarks. I would be happy to answer any questions.

1/ For purposes of the now-repealed deduction for itemized State and local sales taxes under section 164 of the Internal Revenue Code, both forms of sales taxes generally were treated as imposed on the consumer, provided that the sales tax was separately stated. See Section 164(b)(5) (repealed); Treas. Reg. §1.164-5; Rev. Rul. 76-87, 1976-1 C.B. 49 (involving a New York State sales tax imposed on the consumer and collected by the retailer); Rev. Rul. 77-465, 1977-2 C.B. 61 (involving a separately stated Minnesota sales tax imposed on the gross receipts of the retailer).

2/ S. 639, unlike S. 1099, refers only to a State's power to impose a sales or use tax, and not to its power to require collection of such taxes. However, we believe that S. 639 was intended to authorize States to require collection of these taxes.

3/ Although the Supreme Court in National Bellas Hess did not expressly base its holding on the Due Process Clause, the Court's analysis and discussion of authorities indicated that the Commerce Clause and the Due Process Clause contain similar requirements of some minimum connection between the State and the person, property or transaction the State seeks to tax. National Bellas Hess, 386 U.S. at 756. The independent significance of the Due Process Clause in this area is also supported by prior Supreme Court decisions. See Miller Bros. Co. v. Maryland, 344 U.S. 340 (1954) (decision barring collection of State use tax from out-of-state retailer based primarily on due process grounds). Thus, out-of-state vendors might challenge on due process grounds any expansion of State taxing authority beyond the limits drawn in National Bellas Hess.

STATEMENT OF

THE HONORABLE GEORGE SINNER

GOVERNOR OF NORTH DAKOTA

and

CO-CHAIR

THE STATE WORKING GROUP ON THE COLLECTION OF MAIL ORDER SALES TAXES

November 6, 1987

Mr. Chairman and Members of the Subcommittee:

I am Governor George Sinner and I appreciate the opportunity to appear before you today to offer testimony concerning S. 639 and S. 1099, bills that would correct the current problem of collecting mail order sales taxes. I represent not only the nation's Governors but the State Working Group on the Collection of Mail Order Sales Taxes. A roster of the members is attached, which includes the National Association of Tax Administrators, The Multi-State Tax Commission, The National Association of State Budget Officers, The National Association of State Auditors, Comptrollers, and Treasurers, and the National Conference of State Legislatures. The National Conference of State Legislatures is separately represented today and is also an active member of the working group.

First, I would like to commend the Subcommittee for focusing congressional attention on this issue, which is very important to state government. The states are obviously concerned about untaxed mail order sales because of the adverse revenue impact, but the primary concern of the states is the extreme unfairness it brings to retail sellers on the main streets of our states.

Mr. Chairman, five percent of gross sales is more dollars than most companies make in profit. A five percent sales advantage is overwhelming to the main street retailer. We must not allow this five percent competitive interstate disadvantage to continue.

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All Business Enterprises: (1983)

	(In Billions) Retail Trade	Total All Businesses
Business Receipts	$1,218.2	7,043.0
Net Income (profits)	23.4	246.1
	(Percent)	
	1.9%	3.5%

Corporations Only: (1982)

	General Merchandise	(In Billions) Apparel and Accessories	Total Retail
Business Receipts	$741.5	36.8	741.5
Net Income	19.1	1.6	19.1
		(Percent)	
	2.6%	4.3%	2.6%

Second, I want to commend Senator Burdick and Senator Cochran for introducing bipartisan legislation to correct this problem. Both bills address the issue, and S. 1099 conforms to language the state groups have developed for both House and Senate consideration. In summary, we support the language in S. 1099, which would make advertising the basis of tax collection, require each state to have a single tax rate, require no more than quarterly remittance, and only apply to large firms with $12.5 million or more in annual sales. This provision alone exempts over 94% of all mail order firms.

In a 1967 decision, National Bellas Hess v. Illinois Department of Revenue, the U.S. Supreme Court ended the obligation of out-of-state direct marketers and border sellers to collect sales (or "use") taxes from buyers and remit the revenue to the home state of the purchaser.

Most of the 46 states (including the District of Columbia) which impose a sales tax on in-state purchases also employ a complimentary "use" tax on out-of-state purchases by their residents. In theory, the 1967 Supreme Court decision did not end the obligation of consumers to remit to their home state "use" taxes on out-of-state purchases; the decision simply ended the requirement that out-of-state businesses collect the tax and remit it to the purchaser's home state. Simply put, the Supreme Court said we can continue to impose a sales or use tax on mail order sales made by out-of-state companies, but we cannot require the companies to collect and remit the tax. We must

rely on consumers to voluntarily pay the tax to their home state revenue department, a procedure that will not work for the collection of taxes.

The Federal Advisory Commission on Intergovernmental Relations (ACIR) estimates that the states are losing a minimum of $2 billion in revenue each year on untaxed mail order sales. In North Dakota, it is estimated that we are losing almost $5 million in revenue each year -- you can imagine the impact on larger states. The impact of this revenue loss is severe, particularly in light of North Dakota's precarious fiscal condition. Attached is a table that gives the estimated tax loss for each state.

Out-of-state businesses threaten the future of the sales tax, which is the second most important state revenue source, accounting for one of every three state tax dollars. Fourteen states rely on sales taxes for more than 40 percent of their revenues. Seven states depend on sales taxes for more than half their revenues. Furthermore, states have been increasing their dependence on sales taxes. From 1974 to 1984, the median state sales tax rose from 3.8 percent to 4.4 percent. The increasing popularity of direct marketers and border sellers is eroding the sales-tax base. ACIR estimates that 38 of the 46 sales-tax states lost at least $10 million each in sales-tax revenues in 1986.

The revenue impact of the 1967 Supreme Court decision has been exacerbated by the explosive growth in mail order sales. Congressional Quarterly recently noted that "consumers have gone on a mail order shopping spree, buying everything from expensive home computers and telephone equipment to a vast array of clothing, kitchen supplies, household tools and other items sold by such companies as American Express, Sharper Image, Brookstone, and Lillian Vernon."

Direct marketers -- whose solicitations methods include mail order catalogs, telephone selling, direct-response commercials, advertising inserts, computer shopping and other high tech methods -- run a $150 billion a year business accounting for 14 percent of all retail sales. By 1990, direct

marketers are expected to control at least 20 percent of retail sales, according to the Direct Marketing Association. The law needs to be updated in light of these basic and growing changes in the market place.

Changing technology will make mail order shopping more convenient than ever, with personal computers and cable television providing direct links between buyers and sellers. BusinessWeek, in a December, 1986, report on "home shopping," predicted that "within three years, almost anyone with a telephone and a television set will be able to shop at home." Home shopping sales hit $450 million in 1986 and according to industry analyst Paul Kagan Associates, sales could pass $2 billion in 1987. More than 50 million people -- more than half of all homes with television -- will be able to tune in to a home shopping program by late this year. The president of a company about to launch a cable television shopping program said the company will provide consumers with a "sort of electronic mall" by combining the products of more than 100 catalogs in one program.

In addition to cable televisions's home shopping programs and computer shopping, major national retailers, such as Bloomingdale's, have established mail order businesses by setting up a separate corporate identity designed to permit interstate sales without the collection of the use tax.

The unfair advantage for out-of-state firms threatens the future of Main Street America. Sales by out-of-state firms are rising faster than those of traditional retailers -- at a conservative estimate of 9 percent a year. Traditional retail sales are increasing at 5.7 percent a year.

Economists Ronald C. Fisher of Michigan State and John Mikesell of Indiana University estimate that a 1 percent increase in a sales tax rate may reduce local retail sales 6 percent, as consumers find ways to beat the tax. These sales losses to Main Street merchants are gains for direct marketers and border sellers. Thus, retailers and state tax administrators are caught in a vicious cycle: declining in-state retail sales force sales tax rates up to make up for reduced revenue. Higher sales tax rates chase more customers to

out-of-state firms, who have a price advantage equal to the tax rate of the customer's home state. ACIR concludes that the "virtual tax immunity" of out-of-state firms sends customers to direct marketers and border sellers.

The tax-free appeal of mail-order merchandise may increase with the recent enactment of the tax overhaul measure. Since the new law ends the deductibility of state sales tax on federal income tax returns, more consumers -- to avoid paying a levy they can no longer deduct -- will be lured to the mail-order business.

In North Dakota we have 26,000 retailers, all of whom collect the 5.5 percent state sales tax. The untaxed sales transactions of their out-of-state competitors creates an unfair price advantage equal to the 5 percent tax rate of North Dakota whenever purchases are mailed or delivered into the State. Art Wheeler, president of the North Dakota Retail Association, said "If direct marketers continue to replace the American storefront, our nation's unemployment levels will know no bounds, for there may not be Main Street employers to provide jobs and livable incomes to wage earners, our neighbors and friends."

The North Dakota 49th Legislative Assembly adopted a formal request of Congress to adopt legislation which would allow states to require out-of-state companies to collect and remit sales tax on all transactions. I am here today on behalf not only of the NGA, but also on behalf of North Dakota and nationwide Main Street retailers who may not survive the competitive tax advantage enjoyed by mail order companies.

Mr. Chairman, attached to my testimony is a copy of current NGA policy, a roster of the State Working Group, a table on state revenue losses, and a list of the 71 cosponsors of similar legislation in the House.

We look forward to working with the Committee to pass a bill which will restore the integrity of state sales taxes and eliminate the competitive advantage out-of-state business enjoy over our Main Street retailers. We commend the Subcommittee for this hearing and urge you to press forward toward reasoned and effective legislation.

OUT-OF-STATE SALES TAX COLLECTIONS

The National Governors' Association supports corrective federal legislation that would permit the states to require large out-of-state mail order firms to collect state sales and use taxes. The legislation should conform to the following principles:

- Apply to only large firms with national or single state sales of tangible personal property in excess of reasonable de minimus levels nationally and in each state.
- Apply to firms engaged in regular, systematic solicitation of sales in a state.
- Be imposed only when the state has established a uniform rate for the state, including any minimum, statewide, local sales tax rates.
- Include reasonable return and remittance requirements of not more than quarterly.
- Apply the tax to the sale or use of tangible personal property.

The Governors call upon Congress to exercise its powers to regulate interstate commerce to grant the states authority to collect their own tax owed on these interstate mail transactions. Such action would restore fairness to competition between community and out-of-state mail transactions and provide a means for the states to collect already-owed taxes.

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11/4/87

Table 2

Estimated Revenue Potential from Mail Order Sales Unadjusted for Nexus and *De Minimis* Provisions, 1985-88

	1985 Est.	1986 Est.	1988 Est.
Alabama	$23,840	$25,260	$29,620
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Hawaii	8,110	8,700	10,200
Idaho	7,450	8,040	9,430
Illinois	98,430	103,760	121,690
Indiana	44,120	46,270	54,290
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(L)—Local sales tax levied at minimum uniform rate throughout state is included.

LIST OF COSPONSORS TO BOTH BELLAS HESS BILLS
IN ALPHABETICAL ORDER - 10/19/87

MEMBER	PARTY	STATE	COMMITTEE	HR 1242	HR 1891
Gary L. Ackerman	D	New York	---	C	--
Michael A. Andrews	D	Texas	W&M	C	C
Richard K. Armey	R	Texas	---	--	C
Chester G. Atkins	D	Massachusetts	---	C	--
Douglas K. Bereuter	R	Nebraska	---	C	C

Sherwood L. Boehlert	R	New York	---	C	C
Robert A. Borski	D	Pennsylvania	---	C	--
Barbara Boxer	D	California	---	C	--
Jack Brooks	D	Texas	JUD	--	C
John Bryant	D	Texas	JUD	--	C
Jack Buechner	R	Missouri	---	C	--
Albert G. Bustamante	D	Texas	---	--	C
Benjamin L. Cardin	D	Maryland	JUD	--	C
Jim Chapman	D	Texas	---	--	C
Ronald D. Coleman	D	Texas	---	--	C
Larry E. Craig	R	Idaho	---	--	C
Hal Daub	R	Nebraska	W&M	C	--
Jack Davis	R	Illinois	---	C	C
E de la Garza	D	Texas	---	--	C
Thomas D. DeLay	R	Texas	---	--	C
Byron L. Dorgan	D	North Dakota	W&M	C	--
Mickey Edwards	R	Oklahoma	---	--	C
Harris W. Fawell	R	Illinois	---	C	C
Harold E. Ford	D	Tennessee	W&M	--	C
Barney Frank	D	Massachusetts	JUD	C	C
Bart Gordon	D	Tennessee	---	--	C
Frank J. Guarini	D	New Jersey	W&M	C	--
Lee H. Hamilton	D	Indiana	---	C	--
Claude Harris	D	Alabama	---	--	C
Charles A. Hayes	D	Illinois	---	C	C
Jimmy Hayes	D	Louisiana	---	--	C
George Hochbrueckner	D	New York	---	--	C
Jerry Huckaby	D	Louisiana	---	--	C
William J. Hughes	D	New Jersey	JUD	--	C
Andrew Jacobs, Jr.	D	Indiana	W&M	--	C
Tim Johnson	D	South Dakota	---	C	--
Ed Jones	D	Tennessee	---	--	C
Martin Lancaster	D	North Carolina	---	C	--
Tom Lantos	D	California	---	--	C
Sander M. Levin	D	Michigan	W&M	C	C
John Lewis	D	Georgia	---	C	C
William O. Lipinski	D	Illinois	---	C	--
Bob Livingston	R	Louisiana	---	--	C
Edward R. Madigan	R	Illinois	---	C	--
G. V. 'Sonny' Montgomery	D	Mississippi	---	C	--
Bruce A. Morrison	D	Connecticut	JUD	C	C
Austin J. Murphy	D	Pennsylvania	---	C	--
Howard C. Nielson	R	Utah	---	C	C
James L. Oberstar	D	Minnesota	---	C	--
James R. Olin	D	Virginia	---	--	C
Solomon P. Ortiz	D	Texas	---	--	C
Timothy J. Penny	D	Minnesota	---	C	--
Nick J. Rahall, II	D	West Virginia	---	--	C
Arthur Ravenel, Jr.	R	South Carolina	---	--	C
Tommy F. Robinson	D	Arkansas	---	--	C
Martin Olav Sabo	D	Minnesota	---	C	--
Gus Savage	D	Illinois	---	C	--
Louise Slaughter	D	New York	---	--	C
Stephen J. Solarz	D	New York	---	--	C
Fernand J. St Germain	D	Rhode Island	---	--	C
Richard H. Stallings	D	Idaho	---	--	C
Fortney H. Stark	D	California	W&M	C	--
Louis Stokes	D	Ohio	---	--	C
Patrick L. Swindall	R	Georgia	JUD	--	C
W. J. 'Billy' Tauzin	D	Louisiana	---	C	--
Edolphus Towns	D	New York	---	--	C
James A. Traficant, Jr.	D	Ohio	---	--	C
Bruce F. Vento	D	Minnesota	---	C	--
Charles Wilson	D	Texas	---	--	C
Robert E. Wise	D	West Virginia	---	--	C
Howard Wolpe	D	Michigan	---	--	C

STATEMENT FOR THE RECORD OF

THE HONORABLE JAMES R. THOMPSON

GOVERNOR OF ILLINOIS

on behalf of

THE NATIONAL GOVERNORS' ASSOCIATION

and

THE STATE WORKING GROUP ON THE COLLECTION OF MAIL ORDER SALES TAXES

Mr. Chairman, I am sorry that I cannot personally appear before you today on behalf of the nation's Governors, to discuss legislation to clarify the right of states to collect sales and use taxes on out-of-state mail order sales. I want to thank Senator Burdick and Senator Cochran for introducing legislation on this issue. As co-chairmen of the National Governors' Association (NGA) State Working Group on Out-of-State Sales Taxes, Governor George Sinner and I have worked actively with governors and other interested organizations to promote a fair and equitable solution to this problem.

As I stated before the Ways and Means Committee in February and again in May of this year, it is imperative that Congress address the need for legislation that will correct the impact of the 1967 Supreme Court decision in National Bellas Hess v. Illinois Department of Revenue. This decision prohibits states from collecting state use taxes on interstate mail order firms unless the seller has a physical presence in the state levying the tax. The underlying principle for this decision was the commerce clause in the Constitution. We are asking Congress to return to the states the taxing powers that existed before federal intervention. We are asking that states be given the right to strengthen and enforce already existing taxing authority. This is not a new tax or a tax increase.

As a result of National Bellas Hess, out-of-state retailers are not required to make sales tax payments to the state unless they have what is commonly called "nexus" within the state. The courts said that businesses do

not have "nexus" if their only contact with the state is through mail-order sales or through delivery to a customer in that state.

The court's decision eliminated the obligation of out-of-state direct marketers to collect these use taxes from purchasers and remit them to the purchasers' home state. The court also ruled that Congress had to authorize the states to collect such taxes from out-of-state businesses. The NGA feels that the court's reasoning for giving special treatment to mail-order firms has proven over time to be faulty, especially in light of the dramatic growth of the direct mail business over the 20 years since the court decision.

The decision clearly puts in-state businesses at a disadvantage with out-of-state and border-state businesses, which have no obligation to collect and remit the Illinois sales or use tax. Not only are in-state businesses being forced to compete with these businesses, but they must continue to collect and pay the state tax.

And, of course, the state loses money. In Illinois that amounts to about $90 million annually. The national figure is conservatively estimated to be over $2 billion annually, and this figure is now growing at a minimum of nine percent a year.

The impact of this revenue loss is becoming more critical as federal programs are reduced, forcing states to pick up more and more costs for vital services -- services that affect our educational, medical, and transportation needs.

According to the Advisory Commission on Intergovernmental Relations (ACIR), 40 of the 46 states that have a sales tax lost at least $10 million each in sales tax revenues in 1986 (the last year that figures were available for comparison). States can no longer ignore the consequences of National Bellas Hess.

I can certainly understand, Mr. Chairman, how this has come to pass. I'm sure in your household, like mine, you have seen an unbelievable proliferation

in the number of mail-order catalogs. It used to be that you could expect to see an array of catalogs from around the country at Christmas time. Now, not a day goes by without at least one, and on some days five or six, catalogs in the mail. I believe most people today use the catalog services for one reason -- convenience -- and not because they are consciously trying to avoid paying sales and use taxes.

We have seen increased usage of "800" toll-free telephone numbers, credit card promotions on television and through telephones, and mail-order catalogs in recent years. Direct marketing businesses now total approximately $150 billion annually and account for 14 percent of all retail sales. That percentage is expected to rise to 20 percent by 1990. It clearly is now a significant threat to our local merchants.

This is no longer an issue that can be left unresolved. I applaud the increased awareness in Congress that a national solution to this problem must be found. The National Governors' Association (NGA), National Association of Tax Administrators (NATA), National Conference of State Legislatures (NCSL), National Association of State Budget Officers, and the Multistate Tax Commission (MTC) have been working together to help craft federal legislation that will be acceptable to all concerned.

This is an issue that should not be dealt with on an individual state-by-state basis, as our Illinois legislature recommended last year. It can only be resolved with federal legislation that will set a nationwide standard for the collection of state use taxes in a fair and equitable way.

We appreciate the early and continued support of Senator Burdick for corrective legislation. In particular, we support the language of S. 1099 which has been approved by the state organizations.

S. 1099 includes an exemption from sales tax collection for companies that have total national sales below $12.5 million and sets a $500,000 sales

threshold for each state. The $12.5 million de minimus provision would apply to less than 150 (5 percent) of all mail order firms.

We support the simple and single test of nexus as defined in S. 1099. We also support the specific inclusion of "use taxes" in the definition.

We support a single tax rate for each state and the collection of local sales tax when a minimum rate is common to all jurisdictions, thus eliminating the need for companies to keep track of thousands of local tax rates.

In 22 states, local governments already receive a portion of any increase in state sales taxes and would benefit from this legislation. We would support a provision that a minimum local sales tax rate could be included in the single state rate so long as this minimum rate was uniform in all geographic areas.

The very fact that this hearing is being held is encouraging to all those who have been working toward a solution to this issue. We look forward to working with the Finance Committee members and all those who are sponsoring this legislation. I am sure that we can reach an equitable and successful solution to the problems caused by National Bellas Hess.

I urge you to consider this issue in the 100th Congress. At a time when states are being asked to shoulder more of the costs for programs, we cannot ignore the loss in revenue from decisions such as National Bellas Hess. The current situation is unfair to everyone -- the customers who pay, the local merchants who must compete at a cost disadvantage, and, ultimately, to the mail-order businesses themselves, for without federal legislation they eventually will face an unending hodgepodge of state and local laws and litigation.

What we face here, Mr. Chairman and members of the Congress, is a growing loss of legitimate state revenue, legitimately imposed, because of changes in the way retail sales occur in America.

To sum it up in a phrase that all of you hear repeatedly, "We don't have a level playing field." Here, there is no level selling field between the neighborhood merchant and the City of Chicago, or the small town merchant in a suburban or rural area of Illinois, or any other state, and those who come into our states by means of the mails or by television and don't charge the same price because they don't have to collect the sales tax. There will never be a completely level playing field between the merchant who must maintain a physical presence, hire employees, and participate in the local community, and an out-of-state solicitor. We understand that. We are not asking for absolute parity when it cannot be achieved because of these overhead costs.

In the name of equity, the sales tax differential between the out-of-state solicitors and those who have been Main Street neighborhood fixtures in America for a long, long time should not be tolerated any longer.

Mr. Chairman, the Governors of most members of this subcommittee strongly support corrective legislation on mail-order sales taxes. We will be glad to work with each of you to make this a reality.

Thank you, Mr. Chairman.

Testimony of Senator Ray Farabee

Texas Senate

on behalf of the National Conference of State Legislatures

My name is Ray Farabee. I am a member of the Texas State Senate and have been for many years an active member of the National Conference of State Legislatures, on whose behalf I appear before you today. I speak today in support of legislation, similar to S. 639 and S. 1099 that would permit states to require out-of-state companies to collect sales or use taxes when these companies target their citizens as a market for their goods.

Federal legislation is needed because the U.S. Supreme Court in its 1967 decision in National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 753, held that out-of-state sellers - who have no physical presence in a state but who nonetheless have systematically exploited the consumer market in that state through mass mailing of catalogues and flyers or through similar direct marketing techniques - are under no obligation to collect sales and use taxes or to remit such taxes to the home state of buyers. One consequence of the National Bellas Hess decision has been that out-of-state sellers are given an unfair competitive advantage over in-state merchants and over direct sellers that have an in-state presence. Another consequence is that states and localities annually lose over $2 billion in revenues that are legally owed but that cannot be collected. Many states, such as Texas, have been forced to raise taxes and reduce services in an attempt to balance our budgets. Facing the prospect of additional service cuts and revenue problems, it is particularly galling to us that sales taxes owed cannot be collected as a result of the National Bellas Hess decision - even if the direct seller does a multi-million dollar business in our state. I therefore speak confidently on behalf of my collegues in the Texas legislature and on behalf of my fellow officers and members of the National Conference of State Legislatures, representing all 50 states and the American commonwealths and territories, in support of federal legislation to overturn the National Bellas Hess decison.

I will address four major reasons that support the conclusion that federal legislation is needed. First, technologies have made major changes in marketing patterns and consumer buying habits; second, local community retailers are placed at a competitive disadvantage against those who use the state as a market but are not required to collect taxes; third, enforcement is increasingly seen as the fairest way to insure increased revenue without imposing new taxes; and fourth, collection of sales taxes by out-of-state sellers would not unduly burden interstate commerce. To the contrary, federal legislation would create a level playing field that would promote efficient interstate commerce.

Changing Markets

More than ever, consumers are purchasing tangible goods using the improved technologies in communications and transportation. Commercial enterprises have long known the cost savings that can result from centralization of distribution centers. With sophisticated technologies, these companies can take advantage of expanded markets without having a human agent in the field. The toll-free telephone call and express delivery replace the salesman.

Basing taxable nexus upon the presence of a human agent in the taxing state was the primary distinction upon which the Supreme Court based its decision to forbid states from requiring tax collection by out-of-state companies. Even twenty years ago, the dissent in *National Bellas Hess* noted that the presence of a human agent was not "meaningfully distinguishable." Today, for purposes of taxation of out-of-state sales, such a distinction is truly obsolete.

Fairness in Interstate Competition

The need for equity in interstate sales competition is another important reason to approve legislation correcting *National Bellas Hess*. Two factors contribute to the competitive advantage for out-of-state sellers. They do not face the costs of compliance, and more importantly, consumers have an incentive to purchase from them, becaues they believe they do not owe taxes on such purchases.

The merchants in my state act as an agent for the state in collecting a sales tax on items purchased from them. Those merchants -- large and small -- face compliance costs. The owners of small businesses may have few employees and little knowledge of the tax laws, and yet they seek assistance and comply with the law. No substantial, practical reason exists for the company with national sales of more than $5 - $12 million, to be given this competitive advantage over your hometown merchant.

The competitive edge in being an out-of-state merchant was noted recently in an article in the *Washington Post Sunday Magazine*, which told consumers how to save money on major purchases. [May 3, 1987]. Tip number 10 was, and I quote:

> "The rules for saving on deliveries and taxes are: Buy out of state from a store that has no branches in your state. Have the item delivered, and you'll avoid taxes. Just make sure the delivery charge isn't higher than the taxes you've saved."

The writer failed to inform the reader that even if the items are purchased in another state, taxes are due in the state of residence. The Supreme Court did not strike down the tax itself, but rather, it eliminated the only efficient mechanism of enforcement. Every state with a sales tax also has a compensating or "use" tax for such purchases.

Tax avoidance is not a fair element of competition.

Improved Fairness Through Enforcement

The National Bellas Hess decision results every year in the loss of over $2 billion in revenues to states and localities (see the attached table showing the revenue loss to each state). These monies are owed to the state and are needed to maintain vital services and avoid additional tax increases. The Supreme Court did not void the tax but merely the only effective means of collecting it. Before states consider additional program cuts or taxes, they should at least be allowed to efficiently collect taxes on out-of-state direct sales.

While a few states on the east and west coasts have been relatively flush, many states continue to experience fiscal stress. Agriculture and energy producing states in particular have been forced to raise taxes and reduce services in order to balance their budgets. In FY 1987, 24 states made cuts in their budgets after they had already been enacted into law. Projected lay-offs of state employees were reported by 12 states. Thirty-one states were forced to raise taxes in fiscal 1987. The margin of safety separating states from serious fiscal problems is relatively small. The total state fund balances at the end of fiscal year 1987 (as reported by 46 states as of June 30) were $5.2 billion, which is 2.4 percent of general fund spending. This is considerably below the $10.2 billion they held two years ago and considerably below the 5 percent level recommended as prudent by many Wall Street analysts. Louisiana and Texas reported deficits at the end of fiscal 1987, and four states projected imbalances at the end of fiscal 1988. Thirteen other states are having serious fiscal problems as indicated by fund balances of 1 percent or less at the end of 1987. States are very poorly positioned to weather a downturn in business.

One of the more popular and successful strategies states have taken in response to fiscal stress is to improve the administration and equity of their tax systems. Additional revenues can be raised without increasing rates by fair and efficient enforcement of tax laws and by closing loopholes. The

states cannot, however, close the Bellas Hess loophole on their own. Congress must act.

No Undue Burden on Interstate Commerce

Reversal of the National Bellas Hess decision would not, as the majority opinion suggests, burden interstate commerce but rather would create a level playing field, facilitating efficient consumer choices and interstate commerce. The Court's "burdening commerce argument" is based on a mechanical test for the "nexus" necessary for states to require sales tax collection, i.e., physical presence, that ignores the realities of the marketplace and that ignores the real benefits that direct sellers receive from the states in which they do business.

Technically, the tax is not levied on the seller but on the purchaser, who of course has nexus with the state and enjoys the benefits of its services. But, even assuming as the Court's opinion in Bellas Hess does that nexus must be established between the seller and the state, it is abundantly clear that such a direct connection exists if there is a "calculated systematic exploitation of the market."

The majority opinion in National Bellas Hess relies on a mechanistic test of how this tax allegedly burdens commerce. The over-simplified definition of nexus as physical presence in the state is largely unrelated, in the context of direct sales, to the policy concerns that underlie the requirement of nexus. Physical presence of salesmen, warehouses and so forth should be simply one indicator, not a definite test, of whether firms receive benefits from the taxing state.

As Justice Fortas explained the issue in his dissent: "Bellas Hess enjoys the benefits of, and profits from the facilities nurtured by the State of Illinois as fully as if it were a retail store or maintained salesmen therein. Indeed, if it did either, the benefit that it received from the State of Illinois would be no more than it now has - the ability to make sales of its merchandise, to utilize credit facilities, and to realize a profit; and, at the same time, it would be required to pay additional taxes."

Nor would reversal of the Bellas Hess decision place undue compliance costs on direct sellers. Many major direct sellers that have a physical presence in most states, such as Sears and Penney's, are complying with both state and local sales tax collections. S. 1099 would require collection of only state taxes and local taxes collected at a uniform statewide rate. As a consequence, the direct seller would have no difficulty in correlating the purchaser's home state to the appropriate tax rate.

Local Sales Taxes

Another issue to address is one that may be raised by local government groups: should legislation require, as S. 639 does, for the collection of local sales taxes? If local sales taxes are levied at a uniform state-wide rate, then there is no compliance problem for direct sellers. But, we understand there is concern on the part of some members of Congress about the burden that would be placed on direct sellers if they were required to collect and remit sales taxes for hundreds of local governments.

Unquestionably, including local sales taxes would increase the complexity of administering the system for direct sellers. But, "de minimus" provisions could exempt small firmsfrom those burdens, it is a reasonable assumption that the large mail order and direct sales firms could adjust their highly automated billing programs and procedures to accommodate local as well as state sales tax collections - though some additional cost and inconvenience would be involved. Major direct sellers with physical presence in most states are apparently coping with both state and local sales tax collections Congress will have to weigh the benefits to local governments against the burdens on direct sellers.

There is one proposal circulating to accommodate the local governments that NCSL would vigorously oppose. This proposal, instead of requiring that out-of-state sellers collect local sales taxes, would by federal law require states to distribute state monies collected from out-of-state sellers to local governments at a rate comparable to the ratio of local sales tax receipts to state sales tax receipts in each state.

In the view of the National Conference of State Legislatures, this proposal would infringe on the rights of states and on the rights of state legislatures in particular. Control of the public purse is the most basic and ancient right of legislative bodies, and control over appropriations, especially of state-generated revenues, is the essence of state sovereignty. There is no precedent for a federal mandate on state legislatures requiring that state funds be allocated to local governments at a prescribed rate.

Closing

In closing, I want to commend the members of this committee for your efforts in granting this issue a hearing. I also want to commend Senator Cochran and Senator Burdick for introducing bills to address the out-of-state sales tax collection problem. Fairness in interstate commercial transactions and in tax administration can be enhanced by your efforts. The National Conference of State Legislatures stands ready to assist in shaping legislation to correct National Bellas Hess and in working for its passage. Thank you for your consideration.

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STATEMENT SUBMITTED TO
THE SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
BY THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS, JOINED BY THE
MULTISTATE TAX COMMISSION, FOR HEARING ON S.1099 and S.639
November 6, 1987

I am John R. Baldwin, Director, New Jersey Division of Taxation. This year I also serve as President of the National Association of Tax Administrators, an organization of the fifty-one state governments.* I am privileged to be accompanied by Mr. R. H. Hansen, who is Chairman of the Utah State Tax Commission and Chairman of the Multistate Tax Commission. The MTC is an organization of nineteen state tax agencies* and has special concerns and activities relating to interstate taxation. This statement is submitted jointly by the National Association of Tax Administrators and the Multistate Tax Commission.

NATA and MTC express their appreciation to this Subcommittee for its invitation to discuss mail order sales tax evasion problems with you. NATA and MTC strongly support S.1099 and the objectives of S.639. This legislation would end a grossly unfair tax advantage which out-of-state business now enjoys over local business. It would also provide the states with $2 billion in annual sales tax revenue needed by state and local governments for critical expenditure purposes.

The National Bellas Hess Decision

The states' inability to collect taxes on interstate sales and the competitive disadvantage burdening local businesses arise from a 1967 U.S. Supreme Court decision, National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 753, 87 S. Ct. 1389.

The Court, in a six-to-three decision, declared that Illinois could not require an out-of-state mail order company to collect sales and use taxes when its only activity in Illinois was the mailing of catalogs and advertising flyers and the delivery of ordered goods by mail or common carrier. In effect, the majority opinion ruled that Illinois could not require an out-of-state seller to collect sales and use taxes unless it had a physical presence in Illinois.

The dissenting opinion held that Illinois should not be deprived of its authority to require the out-of-state vendor to collect sales and use taxes. In the view of the dissenting judges, the out-of-state seller, like the local seller, derived benefits through the continuous solicitation and exploitation of the Illinois consumer market. It also found that the compliance burden on the out-of-state seller was no greater than the burden on mail order firms located in the state, and that excusing the out-of-state seller from the use tax obligation penalized retailers located in Illinois.

*Includes the District of Columbia.

The majority opinion has been criticized by constitutional authorities both for its reasoning and its results. Supporters of the states' position agree with the dissenting opinion that a states' right to tax or to require the collection of a tax should not depend on the presence of solicitors in a taxing state. Instead, the connection between the out-of-state seller and the taxing state should be an economic rather than a physical relationship.

When the decision was delivered in 1967, state tax agencies expressed concern that it would stimulate the spread of

interstate mail order retailers, with a consequent growth in sales tax evasion and state revenue loss. Now, with interstate marketing expanding rapidly, the growth has materialized far beyond expectations.

Impact on State Tax Administration

National Bellas Hess deprived the states of their ability to collect use taxes on sales by out-of-state vendors with no physical presence in the taxing state. The use tax, which complements the sales tax in each of the 46 states imposing such taxes, is critical to the effective operation of a sales tax. Use tax laws impose the same tax on a resident's purchases from retailers outside the state that sales tax laws impose on purchases from local retailers. If a state did not complement a sales tax with a use tax, it would discriminate against local business in favor of out-of-state business by inviting its residents, in effect, to avoid sales taxes through out-of-state purchases.

The National Bellas Hess decision restored the inequities the sales tax states sought to prevent by their universal adoption of use taxes. Before National Bellas Hess, the use tax, like the sales tax, was collected by the retailer--the use tax by the out-of-state retailer; the sales tax by the local retailer. Since the 1967 decision, the out-of-state retailer can sell his product without collecting a tax, while the local retailer must add the tax to the price of the item he charges.

The states have intensifed sales tax enforcement through increased auditing, through programs for the discovery of nexus activity, and through interstate agreements designed to encourage the voluntary collection of out-of-state sales taxes by merchants located near state borders. However, none of these efforts can address the mail order sales tax evasion problem.[1/]

Direct marketers with no physical presence in a taxing state cannot be audited by that state. Nor have the states any means for inducing out-of-state direct marketers to voluntarily collect and pay sales and use taxes. The volume of mail order sales, the geographical diversity of mail order customers, and the fact that every state may be affected are among the factors which prevent the states from effectively using interstate cooperative agreements as a means for collecting the taxes due on such sales.

The states are severely limited in their ability to identify out-of-state mail order purchases by resident consumers. If they attempted to do so, the cost of collecting use tax from a vast number of non-reporting individuals would be prohibitive. In practicial effect, the 1967 decision made it impossible for the states to administer effectively a consumer's tax that is both valid and essential to state tax systems.

The underlying principle of state excise taxation is that the tax must be collected from the seller. If the states cannot require mail order firms with no physical presence in the state to collect use taxes, then the taxes due on such transactions are not collectible. National Bellas Hess has created a situation where the states reluctantly have had to accept huge revenue losses, and local retailers have been significantly handicapped in their efforts to compete against their out-of-state counterparts.

The Growing Impact of National Bellas Hess

In 1967, the impact of National Bellas Hess on state revenues and on local business was disturbing but nevertheless relatively small. In the intervening years, that impact has grown

explosively, as the sale of consumer goods through interstate marketing has emerged as a business phenomenon of the nineteen eighties, and sales tax rates have risen in response to state budgetary needs.

Two decades ago, state and local sales taxes in excess of 5 percent were almost nonexistent. Now, they range to a high of more than 8 percent. In over half of the states, combined rates are 6 percent or more, and in eleven states, they are 7 percent or more.

Interstate marketing has grown even more rapidly than sales tax rates. In 1967 mail order catalogs were virtually the only form of interstate consumer selling. Now, goods are sold across state lines through credit card companies, computers, 800 telephone numbers, television cable advertising, and home shopping clubs. Home shopping clubs have been described as a revolution in marketing. A large majority of firms engaged in this new form of interstate marketing collect sales and use taxes only in the few states in which they have a physical presence. As these operations grow--and industry forecasters anticipate substantial growth--the state revenue loss and the local business disadvantage will both increase.

A study by the Advisory Commission on Intergovernmental Relations[2/] demonstrates the accelerating impact of mail order sales on state sales tax revenues and on the local retail business. According to ACIR studies, the state revenue loss attributable to out-of-state mail order sales approximated $1.9 billion in 1985 and $2.1 billion in 1986. It is expected to rise to $2.4 billion in 1988.

Moreover, the ACIR estimates understate the the actual state revenue loss. ACIR observes that its estimates possibly err on the low side. The estimates are based on conservative estimates of the growth in mail order sales. Even more important, ACIR included no estimate of the impact of rapidly growing TV home shopping sales in its mail order estimates. As ACIR notes in its report, some industry sources predict growth rates of as much as 400 percent a year in such sales in the near future.

The Proposed Legislation Will Facilitate Compliance

S.1099 and the similar bills introduced in the House in this session to correct the National Bellas Hess decision contain provisions which would simplify the out-of-state vendor's compliance with federal law. These provisions include a uniform state-local tax which would be paid to the state only, and a sales threshold (a de minimis rule) which would relieve small out-of-state vendors from the sales and use tax collection requirement. They would also limit the payment of taxes to once a calendar quarter and would bar any state requirements for geographical accounting. Local government sales taxes would be included in the payment to the state if they were statewide and both the rate and base of the local taxes were uniform.

Under the proposed legislation, the compliance requirements for out-of-state sellers would correspond closely to those observed by local sellers. In fact, the bill's requirement that the out-of-state vendor remit taxes only once each quarter is considerably less demanding than is the requirement imposed on local vendors who report on a monthly or more frequent basis in most states. The requirement also provides a significant benefit to out-of-state vendors by permitting them to retain and use sales and use tax collections for a longer period than is permitted local retailers.

Nor would differences in the base of sales tax laws create any significant problems for mail order firms. Apart from food, non-prescription drugs, magazines and clothing (clothing is exempt in only six states), the goods sold by general merchandising mail order firms are almost entirely taxable. Such vendors need examine the state's list of taxables and the tax rate once to learn which of the goods it sells, if any, are exempt, and the tax to remit. Thereafter, the state would notify the vendor of any legislative changes in the list of taxables or the tax rate. Mail order vendors of specialty items--books, holiday goods, small special appliances--would have no problem once the taxable status of the goods they sell was determined.

Studies on vendor's cost of compliance, even those conducted by the direct marketers, indicate that for the largest mail order firms--those whose sales account for the the greatest state revenue loss--the relative cost of collection is nearly the same as that borne by local vendors. As previously mentioned, the de minimis rule would relieve smaller mail order operators from the collection requirement entirely.

It is important to note that mail order firms, such as Sears and J.C. Penney's, with retail outlets throughout the nation, have always collected and remitted use taxes in a manner prescribed by the proposed legislation. The rapidly growing TV home shopping networks, as a rule, collect sales and use taxes only on sales into the few states in which they have a physical presence.

If federal legislation putting all business on an equal sales tax footing is not enacted, local retailers, the relatively few interstate retailers who collect sales taxes, and their customers will be compelled to bear an ever-increasing burden. For some local retailers, the National Bellas Hess competitive tax disadvantage may threaten their survival.

Legislation v. Litigation

NATA has conducted a study which shows that legal authorities analyzing the issue have concluded that Congress may constitutionally permit states to collect sales and use taxes from mail order vendors.[37] Leading authorities take the view that National Bellas Hess was decided on Commerce Clause grounds and not on due process grounds and that the Supreme Court, without impediment, could uphold congressional action to nullify National Bellas Hess.

There are also legal authorities who describe as favorable the prospects for the U.S. Supreme Court negating National Bellas Hess. They view the majority decision as questionable law and unrealistic in terms of current marketing practices. During the past year, at least a half a dozen states have enacted laws which directly challenge the National Bellas Hess decision. Any of these laws may result in litigation on the issue.

For the states, local retailers, and the direct marketing business, federal legislation such as S.1099 would be preferable to extended litigation. For the direct marketing business, S.1099 provides a gross sales threshold below which mail order firms would be relieved of all compliance requirements. It also provides for uniformity among the states with respect to rate, base, and reporting procedures. If federal legislation is not passed, and National Bellas Hess is negated by the courts, the direct marketers would be subject to a myriad of diverse state requirements that could be much more complex than the simple uniform requirements called for in S.1099.

For the states, federal legislation would resolve a major tax problem and would avoid the inevitable escalation that would result from the rapidly accelerating growth in interstate sales. For local retailers, S.1099 would provide prompt relief from an unfair competitive threat which could cause a multitude of bankruptcies before litigation over the issue could be resolved.

Precedents for Federal Legislation

The tax evasion problems arising from the National Bellas Hess decision are wholly federal in origin in that they result from interstate activity which the states cannot control under existing law. There are precedents for congressional action to assist the states in resolving interstate problems which exceed their jurisdictional authority.

Congress has assisted the states by enacting legislation to curb cigarette tax evasion by mail order (15 USC sec. 375-378) and by transportation across state lines (18 USC sec. 2341-2346). These laws halted forms of state tax evasion which the states could not address because of the interstate character of the evasion. Congress has also made the transportation of gambling devices across state lines a federal crime (15 USC sec. 1171-1178), and it declared that the regulation of insurance was a state responsibility in 15 USC sec. 1011-1015. Also, to aid the states in addressing specific problems, Congress has enacted laws related to the interstate movement of stolen property, wagering information and persons seeking to avoid prosecution.

These are a few examples of Congress' recognition that state boundaries and limited state jurisdiction create problems which can be resolved only by federal action. The need to curb interstate sales tax evasion and protect state revenues fits into this category.

Summary

NATA and MTC join with the Advisory Commission on Intergovernmental Relations, the National Governors' Association, and the National Conference of State Legislatures in expressing support for expanding state authority to permit states to require out-of-state vendors to collect sales and use taxes. At a time when many states are confronted by serious fiscal difficulties and when federal financial assistance to state and local governments is being diminished, effective state tax systems are critical to the operation of state government. Sales tax revenue accounts for one-third of state tax collections. Without legislation that addresses this problem, this vital source of state financing will be seriously threatened if the growth in mail order sales is not accompanied by a requirement that state sales and use taxes be collected on all such sales, and not solely on sales by local businesses.

1/ For a detailed discussion of this issue, see Use Tax Evasion and National Bellas Hess Legislation, an excerpt from presenations to the Annual Meetings of the North Eastern State Tax Officials and the Midwestern States Association of Tax Adminisrators, by Leon Rothenberg, Executive Secretary, National Association of Tax Administrators in September 1987.

3/ National Association of Tax Administrators: Legal Authorities conclude That Federal Legislation to Overturn National Bellas Hess Would Be Upheld, Research Memorandum 591, 1987.

2/ Advisory Commission on Intergovernmental Relations: Estimates of Revenue Potential from State Taxation of Out-of-State Mail Order Sales, September 4, 1987.

Statement of
CATHY REYNOLDS
COUNCILWOMAN-AT-LARGE, DENVER, COLORADO

on behalf of the
NATIONAL LEAGUE OF CITIES

Good morning, members of the Subcommittee on Taxation and Debt Management. I am Cathy Reynolds -- Councilwoman-at-Large for the City of Denver, Colorado and President of the National league of Cities. I am appearing today on behalf of NLC -- which represents some 16,000 cities through direct membership and membership in 49 affiliated state municipal leagues -- to urge your support for legislation that would authorize the collection of both local and state sales taxes on interstate mail order sales.

We are grateful that these hearings are being held. Our members hope that this will be a first step towards positive action by the Senate. We believe action on this issue is especially important to prevent further erosion of local and state tax bases -- as well as to protect local merchants from unfair competition. In light of the steep cuts in federal funding for municipalities, the adverse impact of tax reform on the ability of cities to raise revenues, and the growing cost of meeting federal mandates, prompt action on this vital legislation is in order.

I am here today to outline the special needs of local governments and to urge protection of our interests as well as those of state governments.

Congressional enactment of legislation to authorize the collection of local and state sales taxes on interstate mail order sales is essential for both state and local government. Unless legislation is enacted, state and local revenue bases will erode further in the years to come as interstate sales grow by leaps and bounds. Mail order sales and other sales are projected to go from the

present 12 percent to 20 percent of total sales by the early 1990s as direct marketing becomes even more pervasive. Clearly Congressional action is needed if state and local governments are to continue to use the sales tax as a primary revenue source.

I. BACKGROUND

Some 6,705 local jurisdictions in 29 states levied a sales tax in 1986, up 37 percent from 1976. According to the Advisory Commission on Intergovernmental Relations (ACIR), sales and related taxes produced $13.8 billion or about 29 percent of $47.6 billion in total tax revenues collected by cities in 1985. Only the property tax produces more revenue for cities.

In my own city of Denver, our 3.5 percent sales tax produced $150 million in 1985 or 50 percent of general fund revenues. For some cities, sales tax revenues constitute an even greater percentage of local tax revenues: 64 percent in Huntsville, Alabama; 76 percent in Colorado Springs, Colorado; 60 percent in Baton Rouge, Louisiana; and 78 percent in Tulsa, Oklahoma. In New York City, a 4.25 percent sales tax produced $1.6 billion in 1984.

ACIR recently estimated that the 45 states (and the District of Columbia) with sales taxes were unable to collect about $2.079 billion in sales tax revenues in 1986. This sum is projected to rise to $2.439 billion in 1988, even if likely rate increases and television sales are not taken into account. For the nearly 7,000 local jurisdictions with sales taxes, an additional $250 to $500 million in sales tax revenues will go uncollected.

The source of this problem is a 1967 ruling by the Supreme Court in the National Bellas Hess v. Illinois Department of Revenue case. In that decision, the Supreme Court said that a firm which has no link to a state other than mailing catalogues to state

residents and filling their orders by mail cannot be subject to that state's sales tax.

The practical impact of the Bellas Hess decision is to exempt from state and local sales taxes those goods sold by firms which are located out-of-state and which do not have a place of business or other clear presence in the buyer's state. In other words, an in-state seller or a large vendor with multistate operations could be required to collect state and local sales taxes, but an out-of-state vendor with no operations in the destination state could not be subject to a collection obligation. Under the Bellas Hess ruling, only Congress can remedy the situation by authorizing state and local governments to collect sales taxes on interstate mail order and similar sales.

II. PENDING LEGISLATION

There are two bills now pending in the Senate on this issue -- S. 639 and S. 1099. S. 639, although technically flawed, recognizes that local sales taxes as well as state sales taxes should be covered by the legislation. S. 1099, sponsored by Sen. Thad Cochran (R-Miss.), on the other hand, does not protect the interests of local governments as currently drafted.

S. 1099 effectively bars the collection of local sales taxes, while authorizing the collection of state sales taxes. It achieves this result by establishing as a condition for collection that local rates and coverage be uniform in all geographical areas of the state. In the vast majority of states where cities have sales taxes, varying rates are employed. In the five states where municipal sales tax rates appear to be uniform, there are aberrations -- such as other levels of local government (e.g., counties, transit districts) imposing a sales tax at a different rate or rates -- which destroy the uniformity.

In addition, we think the threshold proposed in S. 1099 for imposition of a collection obligation -- $12.5 million in annual sales -- is too high and will cut out too many retailers. That theshold should be kept as low as possible, preferably in the $5 million range, and should be no higher than the minimum necessary to ensure the abiltiy to recover administrative costs.

III. RECOMMENDATIONS

We understand that the primary obstacle to coverage of local governments is a fear that such a provision -- because of the number of local jurisdictions involved -- would create administrative problems for retailers. We believe that these concerns are greatly overstated and that a streamlined collection process can be established for local sales taxes.

Bellas Hess legislation, whether or not local governments are covered, will inevitably require the use of computer-based services to ensure the collection of state sales taxes. State sales tax rates and definitions of taxable and exempt items vary from state-to-state, suggesting that computer assistance will be needed to facilitate efficient compliance. In fact, computer software already exists to assist retailers in complying with state and local sales tax laws. (A Philadelphia-based company -- Vertex -- sells the necessary computer software on a subscription basis at a moderate price.)

In light of these practical realities, we believe Congress should enact legislation which enables local governments to mandate the collection of virtually all sales taxes. Collection and remittance procedures can be established which minimize administrative burdens and maximize the collection of local sales tax revenues.

I would like to discuss two possible approaches. Under the first approach, revenue collection would be maximized. Under the second approach, revenues would be lower, but the additional administrative burden on the seller for the collection of local sales taxes would be virtually non-existent.

The **first approach** -- our preferred approach -- is to establish streamlined collection and remittance procedures which mitigate the costs associated with vendor collection of local sales tax. Under this approach, both states and local governments could recover virtually all sales tax revenues owed under state and local law.

Collection Procedures: Collection costs can be reduced by the establishment of a national clearinghouse -- to be financed and operated by the state and local jurisdictions which benefit from enhanced sales tax collections. The clearinghouse would provide up-to-date information to both sellers and buyers via a cost-free "800" telephone number.

Remittance Procedures: Remittance costs could be minimized by establishing a zipcode-based system of information returns and revenue distribution. Under this approach, non-resident sellers would be required to file a single tax return on a quarterly basis for each state -- it would cover the state and all affected local jurisdictions -- and remit tax receipts on the same basis. The return would state the gross sales tax receipts collected for the quarter from goods delivered to buyers in the state and its local jurisdictions; the seller would remit the receipts to the state in the form of a single check to cover all sales taxes collected for the state and its local governments.

The seller would also be required to include certain supporting information, also organized on the basis of zipcode, pertaining to

the affected transactions. The state would be required to pass through the applicable tax receipts to the appropriate local jurisdiction on the basis of the zipcode information.

Under the second approach -- a compromise proposal which would result in lower revenue collections for states and cities in a number of states -- a single sales tax rate would be imposed on all interstate sales to residents of the state, with the resulting revenues to be divided among governmental units in the state in accordance with their pro rata share of normal state-wide sales tax receipts. The tax would be collected at the state rate or a uniform state-local rate. The combined state-local rate would be collected only if a uniform rate or a uniform minimum rate (i.e., that portion of the local rate applicable to all comparable transactions throughout the state) existed.

Collection of Local Sales Taxes: Under this second approach, local sales taxes would be collected only in states where the collection of local sales taxes would impose no added administrative burdens on retailers. The definition of a collectable sales tax would include a state sales tax and a uniform local sales tax. In addition, in a state where the local rate is not uniform (but all local governments have a sales tax of some sort), the lowest commonly applicable rate would be collected.

To summarize, collection obligations would fall into one of three categories, depending upon the state-local sales tax structure. First, if a uniform local rate is used throughout the state, then interstate non-nexus retailers would be required to collect the full local sales tax along with the state sales tax.

Second, if all local jurisdictions in the state have a sales tax but the rate varies from jurisdiction to jurisdiction, then the local sales tax would be collected on all interstate transactions at the lowest local rate, along with the state sales tax.

Third, if some of the local jurisdictions in a state do not have a sales tax, then only the state sales tax would be collected and submitted to the state.

Distribution of State Sales Tax Receipts to Local Governments: In any state where local governments impose a local sales tax, the state would be required to pass through a portion of the sales tax revenues collected on interstate sales. This obligation to share revenues would apply even if the local sales tax is not collected in conjunction with the state sales tax. Tax receipts would be allocated between the state government and the state's local governments under the same formula -- in accordance with each jurisdiction's proportional share of normal (i.e., intrastate and nexus interstate transactions) sales tax revenues for the previous year.

In other words, if normal state and local sales tax collections for the previous year totalled $5.0 billion in a state ($3.0 billion in state tax receipts and $2.0 billion in local sales tax receipts), then the state would receive 60 percent of the revenues collected under this legislation and the local governments would receive 40 percent. The local share would be further apportioned among the local jurisdictions in the state in the same manner. For example, a city which received $100 million in normal sales tax receipts for the previous year would receive two percent ($100 million divided by $5.0 billion = 2 percent) of the total revenues collected under the proposed legislation.

IV. CONCLUSION

We strongly urge prompt action by the Senate on Bellas Hess legislation. However, it is critical that the legislation address the fundamental needs of local governments as well as state governments. While we stand ready to support procedures which minimize the administrative burdens on retailers, we are opposed to any proposal legislation to deny cities their fair share of the revenues. We look forward to working with the Subcommittee to develop streamlined and fair procedures.

Thank you.

Statement Of

J. CON MALONEY

on behalf of

NATIONAL ASSOCIATION OF RETAIL DEALERS OF AMERICA, INC.

November 6, 1987

Mr. Chairman, Members of the Subcommittee:

I am J. Con Maloney. I am Chairman of the Board of Cowboy Maloney Appliance and Video, a company headquartered in Jackson, Mississippi. We operate five stores throughout the state, selling all types of home appliances, as well as audio and video equipment. In addition, we service the products which we sell. I also serve as the President of Marta of America, a nationwide buying group of approximately 120 retailers whose businesses are similar to mine.

I am appearing here today on behalf of the National Association of Retail Dealers of America, Inc. (NARDA). Headquartered in Lombard, Illinois, NARDA is a national trade association which represents more than 4,000 companies which sell and service a variety of consumer products, including major home appliances, consumer electronics and related items.

Accompanying me is James M. Goldberg, NARDA's Washington Counsel.

We appreciate the opportunity to appear before the Subcommittee today to express NARDA's support for legislation which would authorize state governments to collect sales and use taxes from certain out-of-state sellers.

It has been approximately 20 years since the Supreme Court of the United States, in National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, ruled that a state or local government cannot constitutionally require a vendor to collect and remit sales and use tax unless that vendor has a sufficient connection with the state. In that case, the Court found that the required "minimum connection" was not present when the

vendor's only connection with its customers was by common carrier or the mail.

The National Bellas Hess decision was triggered by the operations of a mail order retailer. In the two decades since that decision, there has been a virtual explosion of mail order selling, with a proliferation of catalogues in use by a variety of product producers. We have also seen the advent of national publications, with newspapers like USA TODAY, The Wall Street Journal and The New York Times appearing on the same day in every major city in the country. These newspapers, and others like them, carry advertisements from sellers who feature toll-free telephone numbers so that readers in distant cities can call without charge and order advertised products at prices which are competitive with those charged by any retailer in the country. The "high tech" age has also seen the emergence of shop-at-home services, using cable television stations and even home computers to generate sales.

All of these types of selling have one common feature: the sellers rarely, if ever, collect sales tax from the jurisdiction into which they are shipping. Using the rationale in National Bellas Hess, these sellers rightfully claim that they do not have the requisite business connection with the state into which they are shipping merchandise. The toll-free shopping number is the 1980's equivalent of the U.S. mail for advertising and order-taking.

Increasingly, NARDA members like myself are competing with these out-of-state sellers. Customers visit our stores, note prices and model numbers, then call toll-free to these national sellers and place their orders. Often, these national sellers charge less than the prices charged by NARDA members (usually because they do not have some of the overhead expenses such as service departments which NARDA members must absorb), but they gain a further advantage because they do not collect state sales tax. Even if the selling price of the merchandise is identical,

customers can still save by not having to pay sales tax on a "big ticket" item. In the case of Mississippi, with its 6% state sales tax, the saving can be substantial; a customer purchasing a $1,000 video camera would save $60 in sales tax alone.

This kind of national competition hurts companies like mine in two ways. First, we lose sales because customers can avoid sales taxes by buying from an out-of-state vendor. Second, if the product needs service, we are called upon to repair an item which we did not sell, often having to accept the less-than-market rate reimbursement provided by some manufacturers for in-warranty repair.

This national competition also hurts my State, which, incidentally, I have served for the last 16 years as a member of the State Senate. Mississippi loses a sale subject to the sales tax, and also loses because an in-state company does not pay corporate income tax on that sale, and an in-state salesperson is deprived of a commission which would be subject to the state income tax. The Advisory Commission on Intergovernmental Relations has estimated that in 1986 Mississippi lost nearly $20 million in sales tax revenue because of out-of-state selling.

In our opinion, it is time to put the competition on a level playing field. We urge the Subcommittee to favorably report legislation to overturn the National Bellas Hess decision and permit state and local governments to require collection of sales and use taxes by out-of-state sellers.

There are several items which should be included in any legislation reported by this Subcommittee:

First, the legislation should cover both mail order and telephone sales; in addition, it should cover sales resulting from customer visits to stores, when delivery is made to another state.

Second, in order to minimize the paperwork burden on small business, the legislation should be limited to those sellers which transact a minimum amount of dollar volume sales in a particular jurisdiction.

Third, the legislation should contain provisions which make it simple for an out-of-state seller to collect and remit local sales taxes which are in addition to state sales taxes.

Fourth, the legislation should provide for a uniform rule on the definition of where a "sale" takes place -- for example, at the point of shipment or the point of receipt -- so that a seller will have clear and unambiguous direction as to which sales tax to collect.

In conclusion, Mr. Chairman, NARDA urges this Subcommittee to promptly report this legislation to the full Committee. We realize that there may be provisions in both S. 639 and S. 1099 which need modification and we would be pleased to work with Subcommittee staff members to insure timely consideration of this most important legislative matter.

SUMMARY OF TESTIMONY

NATIONAL ASSOCIATION OF RETAIL DEALERS OF AMERICA, INC.
CONCERNING INTERSTATE SALES TAX COLLECTION

The National Association of Retail Dealers of America, Inc. (NARDA) represents more than 4,000 companies which sell and service a variety of consumer products, including major home appliances and consumer electronics.

Many of these retailers compete with national sellers, who are able to gain business because, under current law, they do not collect sales tax from the state into which they ship merchandise. These sellers, who use national publications, mail order catalogues and shop-at-home television stations, are depriving traditional retailers of sales because of this unequal competition.

Additionally, state governments are adversely impacted because they lose sales tax revenue and income tax revenue generated from in-state sales and commissions paid to in-state salespeople.

Legislation to provide for a "level playing field" should be adopted, and the Supreme Court's National Bellas Hess decision overturned.

Testimony of

Direct Marketing Association

on

S. 639 & S. 1099

Submitted:
November 6, 1987

Good morning. My name is Alan Glazer. I am President of Bedford Fair Industries, Ltd, a direct marketing company headquartered in Mt. Kisco, New York where we employ more than 300 people. Bedford Fair had sales of between $25 and $35 million last year. We are typical of the thousands of companies that would be severely burdened by the tax collecting and record-keeping responsibilities which S. 639 and S. 1099 would permit states to impose upon national direct marketers.

Bedford Fair is a member of the Direct Marketing Association (DMA), a national trade association representing all facets of the industry, including catalog companies, telemarketers, and direct response advertisers, as well as printers, list brokers, mailing houses, advertising agencies, and direct marketing suppliers that would also be severely impacted by this legislation. I currently serve as a member of the DMA Board of Directors, and I have served as chairman of DMA's Catalog Council. My testimony here today is on behalf of the entire association and its more than 2,700 members.

The mail order tax proposals which have been introduced in this Congress call for altering the traditional and constitutional relationship between the states and interstate commerce by granting states the authority to require out-of-state businesses to collect and pay state use taxes. We believe that these proposals are unconstitutional and unwise. We also believe that the inefficient tax collecting and unproductive costs called for by these proposals would be damaging to the national economy and short-sighted even from a state revenue perspective.

However, the major reason for my testimony concerning this legislation, and the primary reason for the widespread and determined opposition to it, is the impact it would have on direct marketing companies and their customers. The costs for companies to collect these taxes would be heavy for some and ruinous for others, and

the annoyance to mail order customers would, we think, significantly reduce sales.

If the correct tax on mail order purchases could be magically and painlessly calculated and added in (as it is at the cash register in a retail store), then we would not be here today. The fact of the matter is that collecting taxes through the mail is not comparable to collecting taxes in person. Of necessity the procedures are more costly for the companies and more annoying and time-consuming for the customers. A chart comparing the aggravation factor in figuring the tax for mail order customers and the retail customers is appended
to this testimony.

CUSTOMER AGGRAVATION

Without getting into specific problems such as what tax applies to gifts sent to another state or whether postage and handling is taxable in a given state, let me just say that mail order customers, unlike their retail counterparts, must expend effort to determine the tax. They must determine which items they order are taxable, what the correct rate is, and then actually do the computation. We catalogers spend an awful lot of money just getting customers to the point where they feel they want to buy something from our catalogs. Then we do everything we can to make the ordering process simple and easy. The last thing we want to do at that point is to throw in a math problem involving decimals and taxes to really test our customer's motivation to buy. The tax rates under this legislation, it should be noted, would in all likelihood be different from the rate a customer is used to paying in the local stores.

Tax administrators say not to worry and, of course, that's easy for them to say. The millions of mail order customers would not be annoyed at them. They would be mad at the Congress and aggravated with the process of ordering through the mail.

COMPANY COMPLIANCE COSTS

Lost sales and aggravated customers are not even the worst problems that would be created by this legislation. Company compliance costs are what is most troubling to Bedford Fair and other mid-size direct marketing companies. To get some objective

idea of the magnitude of the compliance burden, DMA commissioned Touche Ross & Company to survey the industry. Actual on-site audits were conducted at 30 companies to verify each company's cost elements for tax collection where they are currently collecting the sales and use tax. A representative cross-section of large and small marketers was selected by Touche Ross. Some companies surveyed were collecting in all jurisdictions and others were collecting in only one or a few states.

Here is a summary of the findings of the study:

1. The average direct marketing company spends 15 cents in collection costs for every dollar of sales or use tax collected.

2. The average compensation from the states is just less than one percent, so that the average uncompensated cost of collection is 14 cents for every dollar of tax collected.

3. The single most significant variable affecting collection costs is size of the company. The larger the company, the smaller the cost of collection (generally) as a percentage of total sales or of taxes collected.

4. The results indicate that direct marketers, on average, have 6 or 7 times the collection costs of retailers who can collect sales tax at a cash register. (Comparisons are to the results of a 1982 study of retail collection costs conducted by Peat Marwick Mitchell & Company.)

As the Touche Ross study documents, the average direct marketer now spends 15 cents for every dollar of use tax collected. Those collection costs come right out of profits, of course, and right off of taxable income for state and federal corporate income tax purposes.

Bedford Fair is currently required to collect taxes only on New York sales. Therefore, our New York business is less profitable than our business in the other 49 states. I accept this situation for three reasons:

1. I have freely chosen to locate my business in New York State, and

2. I derive tangible benefits from New York State services and accordingly have an obligation to support the state by payment of taxes and performance of certain duties, and

3. I have a voice in the political process of New York State.

If, as a result of this proposed legislation, I were to be placed in the role of tax collector/use tax payer for the remaining 45 states that collect tax, I believe that a substantial portion of the modest profit margin earned on net sales in each of those states would immediately evaporate. More precisely, it would be spent in unproductive and inefficient tax collecting activities. Many companies would not be able to remain

profitable under these conditions, and a threshold exemption would not save all of them.

Because of the importance of the compliance cost issue, it is surprising that no proponents of the legislation have made the slightest inquiry into the matter. Even the Advisory Commission on Inter-Governmental Relations (ACIR) in 1985 recommended federal legislation in a 66-page "economic study" without any survey of the industry or analysis of compliance problems. As a substitute for analysis, the ACIR study contains the following statement: "It should be noted that technological progress, data processing, and electronic devices (cash registers, calculators, microcomputers, etc.) have probably reduced compliance costs in the last two decades." This is not the kind of analysis necessary for such a drastic proposal, and it is not accurate. Computers are necessary to collect taxes on mail order purchases, but they do not solve or even mitigate all the problems.

As a New York company, we are currently required to collect and remit sales taxes for approximately 82 different taxing jurisdictions within the state. Despite years of attempting to program computers to make these calculations for us, we have been unsuccessful in achieving this goal. The 45 additional taxing jurisdictions which this legislation would make us responsible for would pose even greater problems than the local subdivisions of New York. Not only are the tax rates different, but unlike subdivisions within a state, each state also has different lists of what items are exempt, different ways of defining those items, different lists of what buyers are tax exempt, different filing requirements, forms and procedures, a different set of auditors, and the power to enforce their
assessments in courts of law hundreds and even thousands of miles from our company headquarters.

State taxing authorities themselves recognize the inefficiency of collecting small amounts of tax through the mail. The state of North Dakota, for example, instructs citizens on the state income tax form not to pay any tax if the amount owed is less than $5.00. Other states have similar provisions. Of course, if the taxpayer were standing in front of a cash register in the tax office, they would say in such cases: "That will be $4.37, please."

Customer errors are another significant cost element for all direct marketers, and are particularly large for some. Retailers never have to worry about customers making mistakes in computing taxes. But we direct marketers cringe at the thought of having thousands of our customers doing math problems before determining how much money to send in on their orders. Some direct marketers currently experience nonpayment or underpayment by customers of approximately 9% of the total taxes due, and I am told that the percentage of nonpayment or underpayment increases when companies attempt to collect taxes outside their home state.

Each error dramatically increases our cost of handling the order. Nonpayments present the marketer with a Hobson's choice: we can either return the order and ask for full payment, fill the order and bill the customer for the missing tax, or simply pay the tax out of company profits (the state always wants full payment, regardless). Oftentimes the last alternative is the least expensive and that puts the collection cost on those orders at 100%.

Computers notwithstanding, direct marketers have significant cost elements not present for fixed location retailers, and these are just ongoing costs. No attempt has been made to estimate the one-time costs of creating the system to handle nationwide tax collecting. I would not even know where to begin to turn Bedford Fair into a tax collector and remitter for 45 other states. At a minimum this would involve acquiring computer software, in-house tax expertise, and additional trained personnel. Many companies would be forced to expand or replace computer hardware. The burden of this transition would vary tremendously from company to company depending upon individual circumstances, but I can tell you that most direct marketing companies would be turned upside down. I don't know of any direct marketers who acquired computer hardware or software or set up systems for dealing with orders in anticipation of the possibility of collecting taxes in 46 different states.

The legislation before this committee highlights a problem: that it is very difficult to collect use taxes -- difficult for the state and difficult for the marketers. When these taxes were first enacted decades ago, there was virtually no mail order industry. The sales tax was designed to work in a retail situation. There is simply no way to make this tax work either fairly or efficiently in the context of consumer mail order sales.

Tax administrators point to large national retail chains as proof that it is possible to collect taxes on mail order sales nationwide. I don't know if this is a serious argument, but the situation with regard to mid-size catalog companies such as Bedford Fair is in no way comparable to that of these multi-billion dollar retail giants. For catalogers with a retail presence in every state the cost of collecting each state's use tax is greatly diminished by the fact that all of the analysis of each tax law and its effect on the company product line is already done as part of the retail store operation. In addition, many of the personnel necessary to deal with tax collecting and record- keeping have already been hired or retained.

National retailers are also in a position to minimize or eliminate the costs of customer error and nonpayment of tax by offering revolving credit charge cards and the opportunity to pick up catalog orders at hundreds of retail locations. Finally, it should be noted that the national retailers can spread their sales and use tax collection costs over literally billions of dollars of total retail sales. This reduces the relative burden dramatically.

What about the example of some smaller direct marketers? Catalog companies such as the Talbots, the Sharper Image, Eddie Bauer, Banana Republic, Brookstone, and others are now collecting taxes in many states on their catalog sales because they have retail operations in those states. In each case the company made a calculated business decision that it was worth the increased burdens in order to take advantage of the retail potential which their catalogs had stimulated in those various states. The legislative proposal before this subcommittee would force hundreds and hundreds of direct marketers who have neither the ability nor the desire to expand into retail at this time to absorb the increased tax collecting costs of a sudden expansion into all 50 states at once without any of the benefits of an actual retail expansion.

One last point on compliance costs. Tax administrators have explained to direct marketers their lack of interest in compliance burdens by stating that "It's the cost of doing business." But is it? It is true that any burden that government places on businesses becomes a cost of doing business. However, under current law, purely out-of-state direct marketers have no obligation to collect taxes for states where they have no presence. So actually these burdens are <u>not</u> a cost of doing business for

direct marketers. Tax administrators have come to Congress to try to make them a cost of our doing business.

FAIRNESS

State tax officials argue that we need to "level the playing field" by requiring all marketers to collect a sales tax or a use tax. I have already attempted to explain that this legislation would not create a level playing field since the problems associated with the collection of a use tax on mail order purchases are much more severe, both for the seller and the buyer. But fairness in tax policy also has to do with benefits. Sometimes higher tax burdens are justified by greater benefits. One might expect that state tax officials are justifying the imposition of greater burdens on mail order companies because they receive greater benefits from the taxing state. However, just the opposite is true. States provide considerable benefits in terms of police and fire protection, sanitation services, etc., for businesses located within their borders.

Mail order companies with property or even one employee in a state currently collect that state's use tax in return for state services. This legislation would force mail order companies with no presence in a state to absorb the cost of collecting the state use tax in return for no services. In addition, without employees or property in a state, a company is without a political voice to affect those tax laws or to appeal from the often heavy-handed tactics of tax collectors.

CONSTITUTIONAL ISSUES

In fact, there are more fairness arguments against this legislative proposal than in support of it. The nexus standards which tax administrators would have Congress do away with were derived from the Commerce and Due Process Clauses of the U.S. Constitution. The concept of nexus is an attempt by the U.S. Supreme Court to determine the fairest possible way of determining who should and who should not be required to collect state use taxes. The Court determined that fundamental fairness demands that a company have some presence in a state and receive some benefits from that state in order to justify the collection duties imposed.

Doing away with the nexus concept in this context would also establish an extremely dangerous precedent. The recently enacted Florida advertising tax on national advertising demonstrates once again that states desperate for revenue are not shy about passing tax laws which are constitutionally unenforceable. It is arguable that the legislative proposal before you today would give Florida the extra constitutional authority it needs to collect tax on national advertising with pernicious results. Whether or not Florida retains its current services tax is not the point. In any case, granting authority to the states to tax and otherwise burden interstate commerce without regard to nexus opens up a Pandora's box of evils for the national economy.

S. 1099 presents still another constitutional problem. In an effort to mitigate the enormous problems of collecting use taxes, this bill authorizes an unprecedented federal intrusion into state tax policy. Even more limitations on the rights of states and their subdivisions to control their own tax policy would be necessary in order for the bill to be minimally feasible.

This federal intrusion may seem welcome in the short term. State sales and use tax laws are for the most part a hopeless maze of complexities developed over years of responding to various political pulls and pushes. As welcome as federally-mandated simplifications may seem, this is a dangerous road to start down. The long-term implications of federal involvement in state tax policy are likely to cause more irritation than harmony, and this level of intrusion may itself be a violation of the constitutional principle of federalism.

REVENUE ESTIMATES

All else being equal, if these bills were reasonable proposals for collecting more taxes, then the size of the revenue estimate would not matter. And in this case, the main point to be made is that more of the proposals currently before the congress are reasonable -- they are drastic measures which would, in addition to tampering with constitutional principles, create serious practical difficulties and revenue offsets as well.

In this context we feel it is useful to correct the revenue estimates used by proponents for the following reasons:

a) Revenue is the sole justification for the federal legislation (the "level the playing field" argument is not relevant to about 95% of the product categories sold by both retailers and direct marketers, and the legislation creates more unfairness than it cures);

b) The revenue estimates are not just a little off, they are twice the size of the actual potential revenue gain for the states; and

c) This is not a case of experts disagreeing concerning projections that depend upon assumptions. We are dealing with an existing tax, objectively determinable figures, and identical starting points. It is a simple case of the ACIR consultant doing a sloppy study and getting the wrong answer.

Therefore, in 1986 the Direct Marketing Association commissioned Robert R. Nathan and Associates (RRNA) to perform an economic study in order to check the accuracy of revenue estimates in the 1985 ACIR report. RRNA was instructed to begin the tax revenue calculations with the same industry sales figure as the ACIR used in their higher of two estimates. RRNA then worked with the compiler of these industry sales figures to make sure that all tax-neutral categories were removed before the tax calculations were made.

Here is a summary of the study's findings:

1. Only $694 million in additional state and local tax revenues could have been generated had the proposed legislation been in effect in 1984, which is less than half of the ACIR estimate.

2. Fifty percent of taxable mail order sales by companies with at least $12.5 MM in mail order sales (the threshold in the ACIR recommendation) are already subject to a collection duty.

3. When compared to existing state and local revenues, the additional revenue potential of the proposed legislation averages only 0.13 percent of current receipts.

4. The revenue figures are based on the assumption that every penny of uncollected tax could be collected at no cost to the state governments and with no adverse affect on other sources of revenue. In actual fact, states would realize only a fraction of the revenue identified.

5. According to documented trends in the direct marketing industry, it appears that the amount of uncollected tax on mail order purchases is likely to decline in coming years without any change in the law. Companies involved in direct marketing are voluntarily acquiring nexus in many states because of marketing advantages, for example: opening retail stores (dozens of well-known catalogers have already opened stores in multiple states), establishing 800 number calling centers, and setting up regional distribution centers for faster delivery.

A recent update of the flawed ACIR study reports adjustments for two of the three major factors overlooked in the original report. These partial adjustments so diminish the revenue estimate that even after multiplying by a substantial annual growth factor (8.4%), the adjusted ACIR projection for 1988 is actually lower than the original ACIR revenue figure for 1985! Unaccountably, the ACIR has buried this figure on page eight of their new report and instead has highlighted unadjusted figures in a full page chart with a state by state breakdown.

Thus, the spotlighted figures in the ACIR update give revenue estimates which include amounts that are already being collected as well as amounts that could not be collected under the proposed legislation. Nevertheless, Congressman Dorgan and others are using these unadjusted figures in support of this legislation.

SHRINKING PROBLEM

Both bills before this committee would mean an unprecedented expansion of state taxing power, a violation of traditional constitutional values, unproductive costs for American businesses, and damage to the U.S. economy in the pursuit of a negligible amount of state tax revenue. But perhaps the greatest problem with this legislation is that it is unnecessary. It is a drastic and expensive solution to a problem which is getting smaller by itself.

Tax officials have taken a quick and superficial look at direct marketing and concluded that mail order buying is a rapidly growing hole in state sales tax coffers. Based on this conclusion, state tax administrators have in the past three years devoted an extraordinary amount of energy to this issue, inciting local retailers against out-of-state companies and advocating congressional action to grant states power over interstate commerce.

However, the need for federal legislation in this area should not be based on such a superficial analysis of direct marketing. Yes, the industry is still growing (although not as rapidly as in the previous decade). But take a closer look at the new growth areas of direct marketing: political fundraising, charitable fundraising, insurance sales, and the sale of investments and financial services. What, pray tell, do any of these

have to do with sales tax? Nothing. Yet the figure used by tax administrators in newspaper articles and speeches to represent the size of direct marketing and its threat to sales tax revenue is invariably three times too large because it contains the $80+ billion a year in direct marketing "sales" attributable to fundraising and other tax-exempt categories.

Mail order marketing of taxable consumer products is still growing at a healthy, if more modest, pace; but here too the major trends should be a great relief to tax administrators everywhere. The fastest growing catalog operations are moving rapidly into retailing, setting up stores to profit from the demand which their catalogs create among the 40-50% of the American consuming public that wants to see a product, feel it, try it on, and take it home immediately. As more and more companies such as the Talbots, the Sharper Image, Banana Republic, and Williams-Sonoma open stores in more and more states, they are required to collect state taxes on their catalog sales in these states. Likewise, more and more companies are expanding into more states to improve their direct marketing with 800 number calling centers, regional distribution centers, the use of new technologies, etc.

If these trends continue (as industry experts expect), more and more companies will be collecting more tax in more states. Under these circumstances drastic legislative measures would not seem to be called for. It is a good time to remember the words of the ancient Chinese proverb: "Never swat a fly on your neighbor's forehead with a hatchet."

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The Customer Aggravation Factor:

Comparison of Sales Tax and Use Tax

	Sales Tax	Use Tax
Visibility	Almost invisible -- the least noticed form of taxation	Painfully visible -- mail order customers not only have to confront the tax, they have to do all the calculations themselves.
Is the item taxable?	Cashier figures it	Customers must know what is taxable or look it up or guess.
Tax Rate	Programmed	Customers must know what the rate is or look it up or guess.
Total Tax	Cashier figures it	Customers must multiply the correct tax rate times the sale price of all taxable items and add the tax to the price total.
Postage and/or handling -- taxable?	Not applicable	Depends upon state law. (there are four different possibilities)
Gifts -- what tax?	No change	Items shipped to other states are taxed according to the laws of the other state which the customer would have to know or look up or take a guess.

P

JOSEPH A. CONNOLLY

CHIEF FINANCIAL OFFICER

HOME SHOPPING NETWORK

ON

S. 639 AND S. 1099

DECEMBER 18, 1987

Chairman Baucus and Members of the Subcommittee, as Chief Financial Officer, Chairman of the Executive Committee and a Director of Home Shopping Network, the largest electronic marketing enterprise in the country, I would like to submit for review by the Subcommittee on Taxation and Debt Management the following comments regarding S. 639 and S. 1099.

BACKGROUND OF HOME SHOPPING NETWORK

The history of shopping at home via TV began more than a decade ago when Home Shopping Network Chairman Roy M. Speer and President Lowell W. Paxson experimented with the idea of selling merchandise over the air waves. A trial venture with a Florida radio station proved so successful that Mr. Speer and Mr. Paxson moved ahead to capitalize on the opportunity by adding a new dimension to their innovative concept - The Home Shopping Club.

In 1982, the Club moved to regional cable television where over the next three years, programming and systems were refined and the Company enjoyed substantial sales increases. July 1985 marked the Club's national launch with HSN 1, America's first nationwide, discount, 24-hour-a-day shop-at-home TV service via cable TV. It also marked the genesis of a new industry. By September 1986, the Company had begun nationwide transmission via broadcast TV of a second home shopping service - HSN 2.

Today, The Home Shopping Club is transmitted live, via two networks from the Tampa Bay area of Florida, to 14.9 million cable viewing households, 29.6 million broadcast viewing households, and 2.0 million homes with satellite dish receivers.

Home Shopping Network maintains distribution facilities in Florida, Iowa, Nevada and Virginia. In addition, it has numerous subsidiaries, engaged in various lines of business, operating in nine other states.

Home Shopping Network prides itself on its innovative concepts, its desire to be the leader in the industry, and its ability to be at the forefront of industry technology.

POSITION OF HOME SHOPPING NETWORK

Home Shopping Network opposes legislative efforts, specifically S. 639 and S. 1099, to give states the authority to require out-of-state retailers to collect and remit state sales taxes. Home Shopping Network operates in accordance

with the National Bellas Hess Supreme Court decision which ruled that a company must have sufficient business contacts with or presence in a state (which, for shorthand purposes is called "nexus"), before that state can require the company to collect sales tax on the state's behalf. In National Bellas Hess, the Court held that the mere solicitation of mail order sales and the subsequent delivery of goods through interstate channels did not create sufficient nexus. It is our position that regular solicitation of sales via televised or other advertising media likewise does not create sufficient nexus with a state to allow that state to require collection of sales taxes. An out-of-state retailer's use of federally regulated airwaves to solicit sales of its goods creates no more presence in a state than the use of the mails to distribute mail order catalogs.

DISCUSSION OF S. 639 AND S. 1099

Both S. 639 and S. 1099 are designed to expand the power of the States to impose sales or use tax collection responsibility on out-of-state retailers that currently are under no obligation to do so pursuant to National Bellas Hess, Inc. v. Illinois Department of Revenue, 386 U.S. 753 (1967).

S. 639 provides that any state or any of its political subdivisions shall have the power to impose a sales or use tax on (1) any interstate sale of tangible personal property by a person located outside such state or political subdivision, or (2) the use of tangible personal property in such State or political subdivision acquired through any interstate sale by a resident of such state or political subdivision, from such a person. The term "interstate sale" is defined by the bill to mean "a sale in which tangible personal property sold is shipped or delivered by common carrier or the United States Postal Service to the purchaser in a State from a point outside such state."

S. 1099 provides that a state shall have the power to require a person to collect a state sales tax imposed with respect to a sale of tangible personal property if the destination of sale, by any means of delivery, is in such state and if certain other conditions are met. First, the seller must engage in regular or systematic solicitation of sales in such state. For this purpose, "soliciting of sales" means making known that a kind of tangible personal property is for sale. Second, the seller must have gross receipts from the sale of such tangible personal property that exceed $12,500,000 per year nationwide or $500,000 per year in such state. For this purpose, annual receipts are measured using the one-year period ending on the September 30th preceding the calendar year in which the sale that is the subject of such tax occurs. In addition, S. 1099 allows the imposition of local sales taxes in a state only if all local jurisdictions in the state impose a sales tax on the same property at the same rate and such local sales tax is collected and administered by such state. Finally, sales tax returns would be filed with the state only on a quarterly basis and an accounting of sales tax receipts on a geographical basis would not be permitted.

Although S. 639 and S. 1099 are each designed to authorize states to require collection of sales and use taxes

from out-of-state retailers, the bills have several important differences. First S. 1099 operates to require a seller to collect a state sales tax only if the seller engaged in "regular or systematic soliciting" of sales in the state. S. 639, on the other hand, does not require that there be any minimum contacts or nexus between the out-of-state retailer and the state other than the delivery of property into the state.

A second difference is that S. 1099 applies a de minimis threshold to exempt small retailers from the operation of the bill. In contrast, S. 639 applies to all out-of-state retailers, regardless of size.

Third, S. 639 authorizes local jurisdictions to impose local sales and use taxes on interstate sales, thus requiring the interstate retailer to face a myriad of local tax rules and reporting obligations. S. 1099 authorizes collection of local sales taxes only if the tax is the same across the state and is collected and administered by the state.

Finally, S. 1099 attempts to limit the compliance burden by limiting the number and frequency of tax returns that may be required by a state. S. 639 has no such provision.

In summary, S. 639 is a bill that would legislate away the existing immunity from sales tax collection responsibility for interstate retailers and would place on interstate retailers the same sales tax collection and reporting obligations required of local retailers. In essence, an interstate retailer, having an actual business presence in only its home state, could be required to collect and account for sales taxes in 45 states and the District of Columbia, plus over 6,000 local jurisdictions. S. 1099, on the other hand, would only apply to interstate retailers with sales volumes exceeding stated minimums, would provide for less complicated reporting obligations, would limit the extent to which local sales taxes are imposed, and would require minimum contacts or nexus with a state before any collection responsibility would be imposed.

DE MINIMIS THRESHOLD

It is important in any legislation that recognition be given to the burdens that would be placed on small businessmen. If S. 639 were passed in its present form, every retailer making sales to customers in states other than the state of commercial domicile would be required to collect and account for sales taxes in all jurisdictions where its customers reside. To impose this burden, without regard to the size of the retailer, would result in legislating out of existence many small businesses.

Home Shopping Network operates on such a large scale that any imposed de minimis threshold would be of little significance. If the de minimis threshold of S. 1099 were passed, Home Shopping Network would be required to collect sales taxes in all 46 taxing states (including the District of Columbia). Even though it will afford us no relief from an increased tax compliance burden, we wish to point out the problems we see associated with the proposed de minimis threshold.

First, assuming that a retailer engages in regular or systematic soliciting of sales in a state, S. 1099 would require a retailer to collect sales taxes in that state if it has annual gross receipts of $12,500,000 nationwide or $500,000 in the state. Because this test is stated in the disjunctive, it is possible for a retailer to have $12,500,001 of nationwide sales, sales in all 46 taxing states, and yet not have sales in any state exceeding $500,000. As written, the de minimis threshold would operate to require that retailer to collect sales taxes in all 46 taxing states. This would pose an unwarranted administrative burden for a retailer that is, in essence, a small business. In fact, it is possible for that same retailer to generate $23,000,000 of annual nationwide sales and still not exceed $500,000 in any state. Assuming an average sales tax rate of 5%, any given state would only receive $25,000 in sales tax collections from that retailer.

Second, S. 1099 would require a retailer, such as Home Shopping Network, to collect sales taxes in all 46 taxing states since its annual sales exceed $12,500,000. In fact, such a retailer could be faced with the burden of collecting in states where it has a very small sales volume, and, hence, minimal business contacts or nexus.

LOCAL SALES TAXES

The collection of local sales taxes is strictly limited by S. 1099 which establishes as a condition for collection that local rates and coverage be uniform in all geographical areas of the state. Various groups, including the National League of Cities, believe that a streamlined collection process can be established for local sales taxes which maintaining the ability of local jurisdictions to impose different rates and coverage.

Two approaches have been proposed by the National League of Cities. Under the first, preferred approach, a national clearinghouse would be established to provide up-to-date information to both sellers and buyers via a cost-free "800" telephone number. Remittance costs would be minimized by establishing a zip code-based system of information returns and revenue distribution.

The second approach would provide that, notwithstanding differing local rates of tax on in-state sales, a single sales tax rate be imposed on all interstate sales to residents of the state, with the resulting revenue to be divided among governmental units in accordance with established tax receipt ratios.

In proposing these alternatives, it is assumed that the large mail order and direct sales firms would only need to adjust their highly automated billing programs and procedures to accommodate local as well as state sales tax collections. It is also assumed that computer software currently exists to assist retailers in complying with state and local sales tax laws, both for the differences in sales tax rates and in taxable and exempt items. Neither of these assumptions is correct.

There are several problems associated with compliance with local sales tax laws, including (1) changing rates, (2)

definitions of taxable and exempt items, and (3) reporting procedures.

Home Shopping Network has significant experience in dealing with the administrative aspects of complying with sales tax rules in local jurisdictions. There are states where some local jurisdictions change their tax rates as often as monthly. While the definition of taxable and exempt sales does not change as frequently, maintaining a current data base of rates and taxable transactions is quite time consuming and costly.

It is true that computer software currently exists to assist in sales tax collection. However, such software is zip code based and deals only with rates. It does not provide assistance with taxable and exempt items. Such software must be internally generated and kept up to date.

Reporting procedures vary with each jurisdiction. While most local sales taxes are administered by the states, others, such as Louisiana, require that sales tax returns be filed with each local taxing jurisdiction. Even where the local jurisdiction's tax is administered by the state, little assistance is provided in complying with the reporting rules (forms are not pre-printed with each local jurisdiction indicated, and the use of internally prepared, computer generated, reports are not encouraged and must meet different format specifications).

The administrative burdens associated with local sales tax collection, especially in multiple states, is more cumbersome, and costly, than those favoring such legislation believe. It is ludicrous to assume that the use of an "800" number will make the burden of compliance easier. Most government "800" numbers are difficult to reach and are answered by staff that are not fully trained to answer all questions. For a company like Home Shopping Network, it would be impossible for our operators, when faced with questions about the applicability of sales tax, to call an "800" number, with a customer on the line ordering a product, and expect a timely response. Home Shopping Network's sales volume is based on timeliness of order acceptance. Our sales would be drastically impaired if our telephone order takers had to be concerned about calling an "800" clearinghouse.

Requiring out-of-state retailers to collect all local sales taxes does not place them on equal footing with local retailers or with national retailers that have retail outlets throughout the country. The local and national retailers collect sales tax at the point of sale, where they have an actual physical presence and where they derive direct benefit from the services and facilities provided by the state and/or local taxing jurisdiction. For each such outlet, a local or national retailer need only be concerned with the rates and rules at that specific location. This is much different than requiring Home Shopping Network, accepting orders only in Florida, to collect sales taxes in Cut and Shoot, Texas, New York City, Moville, Iowa and Nye, Nevada.

COMPLIANCE BURDEN

As already indicated, there is a significant compliance

burden associated with local sales tax administration. Apart from this, there are significant compliance burdens associated with multiple State sales tax collection obligations in general. These include differences in the sales tax base and the possibility of multiple State sales tax audits, as more fully discussed below.

Sales Tax Base

It is unreasonable to assume that the differences in the base of sales tax laws do not pose significant problems for mail order or direct sales firms. Home Shopping Network is involved in direct sales and mail order. From a mail order standpoint, we would have to advise our customers of the tax rates and exemptions for each of the 46 taxing States plus over 6,000 local taxing jurisdictions. This would require us to include a complicated set of instructions in each of our catalogs. Contrary to popular belief, most consumers are not totally familiar with their own state's list of products exempt from sales tax.

Clothing is a large sales item for Home Shopping Network. The differences in the taxation of clothing between the states are numerous. For example, sales of articles of clothing are exempt in Massachusetts, but only up to $175 of the sales price on any article of clothing. In New Jersey, clothing is exempt, except articles made of fur. Children's clothing is exempt in Connecticut, but the exemption only applies to children's clothing for the exclusive use of children who are less than ten years of age.

Home Shopping Network is also involved in mail order sales of prescription medicines and other medical supplies. Prescription medicines are exempt from sales tax in many states, but not in all states. Even in the states that exempt prescription medicines, there are significant differences. For example, in Alabama, prescription medicines are exempt only if sold to persons over 65 years of age. Other states exempt all medicines. The types of medical supplies that are exempt vary greatly between states, and follow no discernible rational pattern.

As the above discussion demonstrates, Home Shopping Network, and any other interstate retailer, would be faced with an extremely complex task of establishing and maintaining a database to cope with the inordinately diverse set of rules that currently exist.

State Sales Tax Audits

A taxpayer does not directly pay for the cost of any audit. Auditor wages and travel expenses are borne by the State agency. However, the taxpayer is obligated to provide an auditor with a place to work and to devote as much time as needed to ensure that the audit is conducted in a timely, efficient and fair manner. This requires a taxpayer to spend time with the auditor. If a taxpayer were subject to sales tax collection responsibility in 46 taxing states, it would be subject to audit by those same 46 states. This would pose an undue burden on the taxpayer to devote the time required for such audits.

STATE COOPERATION

It is reasonable to assume that, if Congress grants the states the power to require interstate retailers to collect state sales taxes, all 46 taxing states will adopt such a law in one form or another. Many states have already adopted similar laws, although their constitutionality has yet to be challenged (California, Oklahoma, Arkansas, North Dakota, Ohio and Nebraska). This would require that Home Shopping Network, and many other interstate retailers, be prepared to conform to the sales tax laws of 46 taxing states in a relatively short period of time. As has been pointed out above, this is a formidable task.

Home Shopping Network has experience in dealing with various states from a sales tax standpoint. While not universally true, some states are unwilling to grant a new sales tax collector any leeway in adopting procedures to comply with the state sales tax rules. Those states expect a new vendor to be totally prepared to comply with the sales tax laws the moment the first sale is made in the state. This is not reasonable or possible. If not totally prepared, the taxpayer will be assessed for uncollected sales taxes. This could be extremely costly.

CONCLUSION

As initially stated, Home Shopping Network opposes legislation that would allow the 46 taxing states to adopt laws requiring out-of-state retailers to collect state sales taxes. Home Shopping Network views such legislation as unconstitutional, as placing such retailers at a substantial disadvantage with respect to in-state retailers, and as creating an undue administrative burden on such retailers.

Home Shopping Network takes its Federal and State tax obligations very seriously. We do not dispute the concern of many state tax administrators that additional sources of revenue are required. Nor do we dispute the fact that sales taxes are owed in all taxing states in which our customers are located. We do take exception to the assertion that we should be required to act in the place of such state tax administrators to collect those taxes on behalf of the states when we do not have sufficient presence in the states to obtain the benefits of state services.

Should any members of the Subcommittee have any questions regarding Home Shopping Network's experience with multiple state sales tax collection and reporting, we would be happy to provide any additional information requested.

Statement of

LUCAS A. POWE, JR.

Professor of Law, University of Texas

November 6, 1987

Mr. Chairman. My name is Lucas A. Powe, Jr., and I am the Bernard J. Ward Centennial Professor of Law at The University of Texas. I hold a B.A. from Yale University, my J.D. from the University of Washington, and I was Law Clerk for Justice William O. Douglas of the United States Supreme Court during the 1970 Term. Since that time I have been on the Texas faculty where my specialty is Constitutional Law. In that capacity I have testified before several committees of the House of Representatives and the Senate and written numerous articles as well as a recent book. In addition to teaching at Texas I have taught Constitutional Law as a Visiting Professor at Berkeley, Georgetown, and the University of Connecticut.

I wish to address the constitutionality of H.R. 1242 and H.R. 1891, which would authorize states to impose tax collection duties on out-of-state direct-mail retailers. National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 753 (1967) and subsequent cases demand a substantial nexus between the state and its would-be tax collecting retailers. These cases make it all but certain that the two bills in question would be quickly declared unconstitutional in whole (H.R. 1891) or in part (H.R. 1242).*

National Bellas Hess was a Delaware corporation doing interstate direct-mail business from Missouri. Illinois amended

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* It is doubtful anyone would support H.R. 1242 without the unconstitutional provisions as the remaining parts are either unnecessary or tied to the unconstitutional parts.

its use tax statute to require firms "soliciting orders within this State from users by means of catalogues or other advertising" to collect the tax on Illinois transactions. The Supreme Court held that the Illinois requirement violated both the Commerce Clause and the Due Process Clause. As to the former, the Court found Illinois had unreasonably burdened the interstate market. As to the latter, the Court held that the solicitation and subsequent delivery through interstate channels did not provide the state with a sufficient nexus to render constitutional its demand that National Bellas Hess operate as a tax collector.

There can be no doubt of the plenary power of Congress over interstate commerce. Congress can legislate to remove barriers to commerce, to create barriers to commerce, or to allow the states to create barriers to commerce. When the Court sustained the McCarran Act in Prudential Insurance v. Benjamin, 328 U.S. 408 (1946), all these issues were finally put to rest. Thus neither H.R. 1242 nor H.R. 1891 raises any questions of constitutionality under the commerce clause even though each would undo the decision in National Bellas Hess.

Congressional power is not plenary under the Fourteenth Amendment, however. Just two years ago the Supreme Court held that an Alabama tax, imposing higher burdens on out-of-state insurance companies, violated the Fourteenth Amendment despite the fact that it was duly authorized by the same McCarran Act. Metropolitan Life Ins. v. Ward, 105 S. Ct. 1606 (1985). Metropolitan Life thus requires that Congressional actions comport with Court decisions construing the Fourteenth Amendment. Neither H.R. 1242 nor H.R. 1891 could legislatively create a Due Process nexus that the Court has held does not exist. To the extent either loosens the requirements of necessary contacts between the taxing state and out-of-state direct-mail retailers, it would be unconstitutional.

In a series of state taxation of interstate commerce cases decided in the 1970s and 1980s, the Court has formulated a four-part test of constitutionality. Complete Auto Transit v. Brady, 430 U.S. 274 (1977). The first prong of the test requires a sufficient nexus between the party and the taxing state. In Commonwealth Edison v. Montana, 453 U.S. 609, 626 (1981), the Court described the first prong of Complete Auto Transit as follows: "Under this threshold test, the interstate business must have a substantial nexus with the State before any tax may be levied upon it. See National Bellas Hess, Inc. v. Illinois Revenue Dept., 386 U.S. 753 (1967)." (Emphasis in original.) Thus the Court requires "a substantial nexus" between the enterprise and the taxing state before the state may make impositions on the enterprise. As the Complete Auto Transit line of cases demonstrates and any observer would already know, few cases present real nexus questions. But some do, and when nexus becomes the issue, National Bellas Hess is the standard. It helps demonstrate what is and what is not "a substantial nexus."

First, what is "a substantial nexus?" If the firm the state has required to collect its taxes has either agents working in the state, Felt & Tarrant v. Gallagher, 306 U.S. 62 (1939), or local retail outlets, Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941), Nelson v. Montgomery Ward, 312 U.S. 373 (1941) the nexus is constitutionally sufficient. When the enterprise has those types of presence in the state it is necessarily receiving the benefits of state government: fire, police protection, services, opportunities. In the frequently quoted words of Wisconsin v. J.C. Penney, 311 U.S. 435, 444 (1940): "The simple but controlling question is whether the state has given anything for which it can ask return." Thus in National Geographic v. California Equalization Board, 430 U.S. 551 (1977), the issue was whether the fact that the National Geographic had two offices in the state and some local sales constitutionally justified the

state's requiring it to collect taxes for its exclusively interstate mail order business. The Court held that this continuous presence by the National Geographic was a sufficient nexus to justify California's demanding that the National Geographic collect its tax.

Miller Bros. v. Maryland, 347 U.S. 340 (1954), demonstrates that the amount of "presence" is the cutting edge of "substantial nexus." Miller Bros. operated on the Delaware side of the Maryland border. It did a substantial Maryland business and occasionally shipped goods into Maryland by its own truck. Yet even the presence in Maryland of tangible personal property in the form of the truck was held insufficient for Maryland to require it to collect its tax.

If actual "presence" may be insufficient, as Miller Bros. shows, then "no presence" will necessarily be insufficient. This, of course, is the teaching of National Bellas Hess. Without a real presence, the amount of direct mail sales is irrelevant. Note that National Bellas Hess was a very large operation. In 1961 it had sales of $60 million nationally and well over 82 million dollars in Illinois. Still Illinois could not force it to become a tax collector.

Nor did the obvious fact that a direct-mail business needs credit facilities affect the National Bellas Hess result. The dissenters (Justices Fortas, Black and Douglas) argued that beyond sales, the necessary constitutional nexus could be found in National Bellas Hess' utilization of Illinois credit facilities. Id. at 762. The majority was unmoved.

Summarizing National Bellas Hess, Miller Bros. and National Geographic, the following points stand out: (1) Some actual presence in the taxing state is not a sufficient nexus. (Miller Bros.) When the California Supreme Court concluded that "the slightest presence within such taxing state" was sufficient, the Supreme Court specifically eschewed reliance on that

formulation. (National Geographic, 430 U.S. at 556.) (2) Very substantial direct mail sales are not sufficient. (National Bellas Hess.) (3) This is so even when the retailer utilizes the credit facilities of the taxing state. (Id.) (4) What is necessary is some actual presence beyond the interstate transaction. Without that, the Due Process Clause bars imposition of the duties of tax collection on an out-of-state company.

With these points in mind, we may now analyze H.R. 1242 and H.R. 1891. The latter is the easier to assess. Beyond regular interstate-sales solicitation, all H.R. 1891 requires for nexus is gross receipts of either $12.5 million nationally or $500,000 within the taxing state. Even in 1961 dollars this is far less than National Bellas Hess' nexus with Illinois which was found inadequate. There simply is no argument for the Due Process nexus of H.R. 1891 except that National Bellas Hess is no longer a viable constitutional decision.

The constitutional questions are a little closer with H.R. 1242. Several of the aspects of "engaged in business" in the taxing state are constitutionally valid (or at least appear to be so), specifically, a retailer deriving rentals from the lease of tangible personal property within the state. If property were within the state on a fairly continuous basis, then the Miller Bros. bar would probably be cleared. Similarly intrastate (as opposed to interstate) advertising is likely to be a sufficient nexus. Under National Geographic, operation by franchisees or other similarly controlled interests are also likely to constitute a substantial nexus.

Serious constitutional problems, however, are raised by section 2(b)(3), which attempts to reach around National Bellas Hess if there are substantial sales where (1) "the retailer benefits from any banking, financing, debt collection, telecommunications or marketing activities occurring in that state" or (2) the retailer "benefits from the location in that

state of authorized installation, servicing, or repair facilities." Yet §2(b)(3) in reality simply restates what National Bellas Hess found insufficient.

Retailers needed to be paid in 1967 no less than they do in 1987 and no one can dispute that credit institutions are a great help. But, as the dissenters in National Bellas Hess noted and argued, credit institutions helped National Bellas Hess. Due Process nexus requires that the state give the retailer something for which the state can demand a return. Wisconsin v. J.C. Penney.

What H.R. 1242 attempts to do is eradicate the requirement that the state provide the retailer something (police, fire protection, the benefits of security). In its place H.R. 1242 would substitute the proposition that the state would provide something to other institutions which in turn could provide the retailer something (in this case either credit facilities or an ability to service the product after sale). The substitutionary approach of H.R. 1242 fails in three ways. First, it is inherently limitless. Taken to its logical stopping point, it would permit a state to justify its taxing out-of-state retailers on the ground that it allows its citizens to have money with which they may choose to purchase from out-of-state retailers. The Due Process nexus requires the state to provide something to the retailer before it can even ask for something in return. Second, as already noted, this very argument was raised in National Bellas Hess -- and it was rejected. Third, the Court made clear in National Geographic that it was not adopting the test of the California Court of "the slightest presence" within the state. If some actual presence is insufficient for these Due Process purposes, then the presence of others is a fortiori insufficient.

Nor would H.R. 1242 be strengthened by combining it with the sales requirements of H.R. 1891 ($12 million nationally or

$500,000 locally). This combination would fall short of the very facts of National Bellas Hess -- millions of dollars of sales backed up by the credit facilities of the state of the consumers -- that the Supreme Court specifically held could not constitute an adequate constitutional nexus.

There remains the point, noted in conjunction with H.R. 1891, that someone might argue that National Bellas Hess is no longer good law. Such an argument, however, would border on the frivolous. First, National Bellas Hess is continuously cited for its Due Process test, and indeed it represents the first prong of the four-part Complete Auto Transit test that the Court has evolved to handle issues of state taxation of interstate commerce. Second, National Geographic provided an opportunity to cut back on National Bellas Hess and Miller Bros. The Court was unanimous in National Geographic* and the facts offered an opportunity to move toward a loosening of the Due Process nexus of National Bellas Hess and especially Miller Bros. Instead the Court cited and relied on both cases. Third, 1987 seems like a very odd time for the Court to adopt a twenty year-old dissent by the only New Dealers left on that Court. Justices Black, Douglas, and Fortas are not the individuals guiding the current Supreme Court. Finally, even the National Bellas Hess dissenters assumed that the costs of tax collection by an interstate retailer are identical to those of an in-state retailer. 386 U.S. at 766. This was just an assumption as there was no evidence on the point in the record. Yet the assumption was wrong. Costs of collection by an interstate retailer are much higher than costs of collection at the cash register. Had the dissenters known this, it is probable that they would have joined to make National Bellas Hess unanimous.

In any event, its result has been approvingly cited for twenty years at the Supreme Court. Legislation like H.R. 1242 and H.R. 1891 will offer false hope to states, force retailers to

pay attorneys fees to litigate, and surely result in a finding of unconstitutionality. There are areas where the jurisprudence of the Supreme Court is in flux and legislation can provide a great assist. Due Process nexus is not such an area. The Court's holdings are clear and in these circumstances the oath to support the constitution requires a vote against bills that run directly counter to the Court's holdings.

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* Chief Justice Burger and Justice Rehnquist did not participate.

STATEMENT OF WILLIAM T. END
EXECUTIVE VICE-PRESIDENT
L.L. BEAN, INC.

My name is William T. End, and I am Executive Vice-President of the Maine mail order firm, L.L. Bean, Inc. Both the company and I appreciate the opportunity to provide testimony regarding S.639 and S.1099 both of which are before the Subcommittee today.

L.L. Bean is a mail order retailer of outdoor equipment, clothing and sporting goods. L.L. Bean is celebrating its 75th year of existence this year and was founded in 1912 by an avid hunter and outdoorsman, Leon Leonwood Bean. Mr Bean's descendants continue to own the controlling interest of the company.

The Company began by selling, by mail, the rubber top, leather bottom Maine Hunting Shoe. Its first mailing was to holders of Maine hunting licenses who resided outside the State of Maine. L.L. Bean was one of the first users of the U.S. Postal Service's Parcel Post Service, which began on January 1, 1913. At the time, the Postal Service charged a penny a pound for items shipped.

Today, L.L. Bean distributes more than 75 million catalogs annually to customers in all of the fifty states and in many foreign countries, and we have sales in excess of three hundred million dollars a year. The Company employs over 2,200 persons.

Despite its growth, L.L. Bean's approach to retailing has remained virtually unchanged. At the current time, we have only one retail store, which has always been located in Freeport, Maine, and is now visited annually by more than two million people. Similarly, all of our manufacturing, distribution and other facilities are located within the State of Maine. Although Freeport, Maine may be remote from many of the major consumer markets in the United States, this country's postal system, telecommunications network and transportation facilities have allowed

us to reach a national market for our products. For example, Bean telephone representatives in Maine handled 5.2 million calls in 1986. L.L. Bean has truly been a beneficiary of America's free and unobstructed national market.

Consumers benefit from a healthy mail order industry as well. People living in rural areas, working couples without time or child-care to permit shopping, all have access to a broad variety of products through mail order. All of us have a greater and more competitive choice of purchasing options through the opportunities created by direct marketing. L.L. Bean's success demonstrates that high quality, good value and excellent service to our customers can be a formula for success even if a company is not located in one of the nation's urban centers.

I am not a lawyer so I cannot testify about the constitutional questions raised by this legislation. I would like to provide this Subcommittee, however, with a direct marketer's ground level view of the burdens and inequities which the proposed legislation presents.

The proposed legislation places a relatively heavy burden on mail order retailers who, in turn, receive none of the benefits resulting from collection of state taxes. For a point of sale retailer, collection of sales taxes is a relatively easy matter. The tax is simply added to the sales price of the product being sold and collected at the register. Sales personnel need consider the rules of only one state. Consequently, there is no confusion over the applicable tax rates, which items are exempt from the tax, or how the tax should be accounted for and remitted to the state treasury.

A mail order company such as L.L. Bean, however, would incur substantial additional costs in complying with the tax laws of 46 separate jurisdictions. First, a mail order retailer such as L.L. Bean would have to advise its customers of the tax rates and

exemptions for each of 46 different taxing jurisdictions. Since the only way L.L. Bean has for providing this information is in its catalog, we would have to include a complicated set of instructions setting forth rates and exemptions for the various states. Moreover, special instructions would have to be provided for the situations where the person ordering the goods lives in one state, but he or she is sending the goods to a resident of another state. A more casual approach to collection of sales and use taxes, such as simply requesting the customer to include the applicable sales tax, would most likely result in substantial non-conformity and present a significant financial exposure to a company such as L.L. Bean in subsequent tax audits.

L.L. Bean has estimated that devoting the catalog space to explain the sales tax rates and exemptions of the 46 taxing jurisdictions would have a direct cost in 1987 of $950,000 and an opportunity cost of $9.5 million of lost sales by reason of devoting valuable catalog space for this purpose.

Furthermore, we would be presenting our customers with complicated information. The success of direct marketing depends upon making the transaction as simple as possible. Once we make mail order complex and confusing for our customers, we discourage their doing business with us. Many people, including myself, are not familiar with their own state's list of products exempt from state sales taxation.

For example, some states exempt apparel for infants from sales tax, while other states exempt sportswear from sales tax. To try to draw the line in one particular state as to what constitutes a taxable item in that state is hard enough. To do that for each of the 46 jurisdictions would be a formidable task.

An additional illustration of the difficulties that would be caused by the proposed legislation is the taxation of shipping charges by some states and the exemption from the sales tax by

other states. L.L. Bean itself does not add a separate charge to its customers for shipping expense but instead charges one price for each item and includes shipping expense as part of its costs of doing business. This method of pricing is done, in part, to make the ordering of merchandise by mail as simple as possible to its customers. It would be very difficult for L.L. Bean to explain in its catalogs how customers should calculate the tax if this method of pricing were retained by L.L. Bean.

Second, all state sales tax laws provide that if the retailer responsible for collecting the tax from its customer fails to do so, the retailer itself is responsible for payment of the tax. The shopkeeper simply collects the tax at the cash register. It is not faced with post-sale collection problems. This would not be the case, however, for a mail order company. Two million of our customers paid for their purchases by personal check. Under the proposed legislation, if customers did not include the sales tax with their payment, or if they improperly computed the tax, L.L. Bean would either have to refuse to deliver the product ordered, pay the tax itself, or attempt to collect the tax after we have shipped the goods. These post-sale collection efforts would run into the hundreds of thousands of dollars. In many instances, the administrative cost of collecting the tax would be greater than the tax itself.

Third, under the proposed legislation, a direct marketer would have to contend with the use tax laws of forty-five different states plus the District of Columbia. L.L. Bean, for example, would be subject to 46 possible different tax rates, 46 separate sets of exemptions, 46 methods of remittance, 46 different timetables for remittance, 46 different auditing procedures, and 46 different auditor visits. L.L. Bean would have to monitor the changes to the tax laws and regulations of 46 jurisdictions where our only contact with these jurisdictions is through the mail. As I understand it, the rules and regulations of each jurisdiction change frequently.

L.L. Bean has no connection to California, for example, other than the fact that it has sold merchandise to residents there. It has been provided no services by California and realizes no benefit from the expenditure of state revenues. S.1099, however, would require us to become tax collection agents for California as well as 45 other states although we are not doing business there, and neither receive nor become eligible for the services which these governments customarily provide to their in-state retailers. The various government services which benefit local businesses are too numerous to cite in this testimony, but, simply by way of example, they include police and fire protection, maintenance of highways and job training programs for employees. L.L. Bean receives these services from the State of Maine, and, consequently, it is only fitting that we provide a reciprocal service to Maine by assisting it in collecting sales taxes on purchases from our retail store in Freeport, Maine, and mail order purchases by Maine residents.

Our only contact with states other than Maine is through the shipment of catalogs and goods. As a business decision, L.L. Bean has chosen to locate all its facilities in Maine. We neither ask for nor receive the services which other states provide to their local businesses.

We do not take lightly the concern of many state tax administrators for finding new sources of tax revenue. The problem with any "quick fix" approach to the out-of-state vendor issue, however, is that it imposes disproportionately heavy - indeed discriminatory - administrative demands on mail order companies when compared to the efforts required of in-state retailers. It should be remembered that the state sales or use tax is imposed on the customers, not on the out-of-state vendor; nonetheless, the proposed legislation would impose difficult and damaging burdens on mail order retailers. The harm and expense to the industry should be carefully considered before imposing that duty.

S.1099 does not eliminate the confusion and disparaties resulting from 46 different tax systems. The equities of this legislation might be different if the states were proposing a uniform sales tax on all mail order sales, with a uniform set of exemptions, a uniform and centralized system of reporting and remittance, and uniform audit procedures. My understanding is that the states have opposed such approaches. It would seem to me to be unfair for the states to insist upon maintaining their right individually to fashion and administer their tax systems, but at the same time look to Congress to assist them in requiring companies located in distant areas to collect taxes.

L.L. Bean has sought to comply with, and has followed, every applicable federal and state regulation. L.L. Bean collects and remits the Maine sales tax. We are very much troubled by S.1099 and S.639 because they would place a heavy burden and cost on us to act as an agent of distant states where we have no connection and realize no benefits. L.L. Bean is not the kind of company that frequently voices opposition to pending legislation. These bills, however, would have such a major impact on the way we do business that we felt it important to make our concerns known. Thank you for giving me the opportunity to testify here today.

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Testimony
Before the
Subcommittee on Taxation and Debt Management
Committee on Finance
United States Senate
November 6, 1987

The American Association of Nurserymen welcomes this opportunity to present the views of the nursery industry with respect to S.639 and S.1099 -- the "Equity in Interstate Competition Act of 1987." This testimony is also presented on behalf of the Mailorder Association of Nurseries.

The American Association of Nurserymen (AAN) is the national trade association of the nursery, landscape, garden center and mailorder industry. We represent more than 4,000 firms across the country engaged in all aspects of the green plant industry -- its grower, landscape, retail and direct mail segments. By almost any standard, our members ae primarily small family-owned farms and businesses. It is estimated that the retail value strictly of nursery crops sold in the United States in 1985 was $5.82 billion.

Mr. Chairman, AAN vigorously opposes both S.639 and S.1099 on the grounds that such legislation would be impractical to implement, and even if it could, either bill would quickly prove exceedingly burdensome to companies engaged (in whole or in part) in mailorder sales. As if these reasons are insufficient, it can be convincingly argued that, even on their face, S.639 and S.1099 are unconstitutional.

Both bills would authorize states and local governments to require retailers to collect sales and use taxes on interstate sales. Currently, a state or local government may impose taxes on sales occurring within its jurisdiction. However, there are obvious limitations on the methods by which state and local jurisdictions may collect such taxes. Although, state and local sales taxes are levied on the final purchaser of goods, they are collected primarily through the vendor.

In 1967, the United States Supreme Court ruled in National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois that state or local governments cannot constitutionally require a retail vendor to collect and remit those taxes unless the vendor has a sufficient business nexus within that state. In this case, the Supreme Court found that the required nexus was not present because a retail vendor's only connection with customers in the state was by common carriers via the postal system.

The landmark decision was based in part on the fairness principle embodied in the due process clause of the United States Constitution. The Supreme Court found that the simple and controlling question is whether a state has given anything for which it can ask in return. Neither a mailorder company nor its out-of-state customers derive any benefits from out-of state services. Businesses with no presence in a state have no political voices there and cannot depend upon ordinary democratic protections. Therefore, it is not difficult to understand that under such circumstances, the Supreme Court ruled it would be wholly unfair to impose tax-collecting duties upon out-of-state mailorder retailers

Simply stated both S.639 and S.1099 would overturn this Supreme Court decision which has stood for twenty years. Of course, it is the perogative of the Congress to seek legislative remedies for judicial decisions with which it may disagree for political reasons. However, even setting aside the powerfully convincing constitutionality of this issue, the Supreme Court decision makes eminent and cogent common sense.

As stated earlier, the collection and compliance costs to a retailer will likely be heavy and burdensome. Although such figures are not available to us, we question whether the amount of revenue, which the states (and political subdivisions thereof) stand to accrue, will outweigh the difficulties with collection which we foresee as absolutely inevitable under either S.639 and S.1099. Presently, we understand that 46 states have applicable sales or use taxes. A salient question which Members of this Subcommittee should carefully consider is how retailers with interstate sales will be able to keep track of each state's tax rate. Just think how much more extraordinarily difficult it will be for mailorder companies to cope with as many as 46 different tax laws than it is for a retail store to cope with a single sales-tax law. Some may say

this is an appropriate price to pay for the so-called "privilege" of conducting business on an interstate basis. However, this is the United States where free-market private enterprise is the proven pillar of this country's economic strength and vitality.

Aside from the different tax rates, states also maintain sets of exemptions which are often amended yearly. To give you an idea as to how confusing this may become, most states exempt sales of fruit trees to commercial orchardists, while a few states tax such sales. A number of states exempt sales of food-producing plants to individual gardeners. Retailers with interstate sales will be required to have a working and, more importantly, current knowledge of the full tax laws in all states. On its surface, this will pose tremendous hardships short of maintaining a bevy of tax experts on the staff of each and every mailorder company to keep abreast of the tax rates and exemptions. When one adds the cost of matching these changing rates and exemptions against a product line, and then communicating specific instructions to customers in every state, this burden becomes excessive. Catalogues and mailings will constantly need to be altered so as to inform customers of their tax obligations.

On top of all of this, most taxes on mailorder purchases are computed by the customers. Errors, underpayments and failures to pay will become an increasingly serious problem for mailorder companies. In fact, it is not too difficult to conceive that this problem may become "nightmarish" with respect to accounting systems and practices, thereby even further exacerbating a firm's compliance costs.

It is clear that the sponsor of S.1099 recognizes the difficulties this legislation will pose for many small businesses as the bill proposes to exempt retailers whose annual nationwide gross sales are less than $12.5 million, or in those states where gross receipts are less than $500,000. AAN appreciates this sensitivity to the concerns of small business. However, we believe the thresholds are too artificially low to satisfy the concerns of truly small businesses. Moreover, we are well aware that irrespective of the size of any possible threshold which this Subcommittee may see fit to adopt, nothing now can prevent actions by future Congresses to lower that threshold. Such prospects are a legitimate concern shared by many small business firms opposed to S.1099.

In conclusion, Mr. Chairman, the American Association of Nurserymen and the Mailorder Association of Nurseries strongly oppose both S.639 and S.1099. We urge the Members of this Subcommittee to carefully consider the many important points raised herein. We believe they represent the practical impediments to any implemention of either bill. Lastly, and most importantly, we urge the Members of this Subcommittee not to overturn the twenty-year old decision of the United States Supreme Court which has already examined the practicality, fairness and constitutionality of this very important issue.

Thank you.

STATEMENT OF THE

AMERICAN FEDERATION OF STATE, COUNTY AND

MUNICIPAL EMPLOYEES

on

THE COLLECTION OF STATE SALES AND USE TAXES
BY OUT-OF-STATE VENDORS

On behalf of the American Federation of State, County and Municipal Employees (AFSCME), I want to commend the Subcommittee for its interest in this vital subject and for affording us this opportunity to present our views.

AFSCME strongly supports legislation which would require out-of-state vendors to collect sales and use taxes and to remit those taxes to the state of the purchaser. We believe such legislation is needed to maintain public services and to protect local retailers from the unfair price advantage enjoyed by out-of-state direct marketers who avoid collecting sales taxes from their consumers.

Our union, which represents 1.4 million state and local government employees, has a direct interest in the ability of our employers to collect the revenues to which they are legally entitled. Our interest in state and local revenue collection is one of long-standing and has been heightened in the 1980s by the enormous reduction in federal aid. Since 1980, federal aid to state and local governments has been reduced by 25 percent in real terms. As a result of these cutbacks, the ability of state and local governments to provide an adequate level of public services has been increasingly dependent on their capacity to raise their own revenues.

However, while state and local governments have been forced by policies adopted in Washington to rely more exclusively on their own source of revenues, technology and congressional lack

of action undermined their ability to enforce their own tax laws and collect the revenues to which they are legally entitled. The new computer and communication technology have given birth to an explosion of direct marketers who regularly solicit across state lines and collect no sales taxes on their out-of-state sales. According to some estimates, sales by mail order firms are rising at a rate more than three times the growth rate for traditional retailers. The Direct Marketing Association predicts that by 1990, direct marketers will control 20 percent of all retail sales. The same association also reports that six billion copies of 6,500 direct mail catalogues were sent to U.S. homes in 1985 -- more than double the figure in 1980 -- and an average of 80 catalogues per home.

The explosion of direct sales by out-of-state vendors has caused state and local governments billions of dollars annually and has exacerbated an already difficult fiscal crisis. According to the Advisory Commission on Intergovernmental Relations, state governments alone will lose over two billion dollars in 1988 because of out-of-state sales. This loss of funds could not come at a worst time for most states. In FY 1987, 24 states were forced to cut their already enacted budgets. In 1982, during the height of the worst recession since the Great Depression, only 23 states cut their already enacted budgets. These forced budget cuts came despite the fact that 24 states enacted tax increases last year. As the table that is attached to our testimony indicates, a good deal of these tax increases could have been avoided had states been able to collect sales taxes on out-of-state sales.

We in AFSCME believe there is a compelling national interest in enabling state and local governments to collect these funds. As a nation, we have a vital interest in improving the competitiveness of our industry and the productivity of our work force. We all realize that a well-educated work force and a sound public infrastructure are essential elements of any policy

to enhance our productivity and competitiveness. However, what Washington policy makers occassionally forget is that state and local governments provide over 90 percent of the funding for elementary and secondary education and over two-thirds of the funding for public works expenditures.

Sales taxes are an important source of funds for the provision of both of these services. Sales taxes constitute nearly 50 percent of the funds raised by state governments. And state governments are now the largest source of funds for elementary and secondary education and continue to be the largest source of funding for public works.

In addition, cities have begun to look to the sales tax as a major source of revenues. The number of local governments with sales tax increased by 40 percent from 1976 to 1986. As a result, sales and gross receipt taxes now constitute 29 percent of the revenues collected by cities.

If our nation is to have an improved educational system and a sound public infrastructure, it is imperative that Congress address itself to the fiscal distress of state and local governments who have traditionally provided these services and are unquestionably the units of governments in the best position to administer them responsively. The traditional federal approach to the financial problems of state and local governments has been through federal grants-in-aid. However, given the current federal deficit, a dramatic increase in aid to state and local governments is not very likely.

With the federal coffers at a low level, it is important that Congress enact laws which make it possible for state and local governments to raise their own revenues to provide for necessary programs. To some extent, the federal government, during the last Congress, took a step backward in this area by eliminating the deductibility of state and local sales taxes. We hope, in this Congress, the federal government will take a step

forward and use its constitutional power to regulate interstate commerce by requiring direct marketers to collect sales taxes and remit them to the jurisdiction of their purchaser. In this way Congress will not only be helping local retailers stay in business, but will also be helping state and local governments pay for the public services needed to make us a more prosperous and productive nation.

OUT-OF-STATE REVENUE LOSS AS PERCENT OF TAX INCREASES

STATE	FY 88 TAX INCREASE ($000)	FY 88 SALES TAX INCREASE ($000)	REVENUE LOSS DUE TO OUT-OF-STATE SALES ($000)	OUT-OF-STATE SALES REVENUE AS PERCENT OF TOTAL TAX HIKE (%)
ALABAMA			29620	
ARIZONA			36190	
ARKANSAS	27000	20000	16110	59.67%
CALIFORNIA			373020	
COLORADO			22770	
CONNECTICUT			60860	
DELAWARE	11000		N/A	
D.C.			10890	
FLORIDA	823000	761000 *	114140	13.87%
GEORGIA			40170	
HAWAII			10200	
IDAHO	56400	47000	9430	16.72%
ILLINOIS			121690	
INDIANA	290000		54290	18.72%
IOWA			22100	
KANSAS			21800	
KENTUCKY			33820	
LOUISIANA			30690	
MAINE			10160	
MARYLAND	143000		56430	37.87%
MASSACHUSETTS			65360	
MICHIGAN			70730	
MINNESOTA	531000	224000	47610	8.97%
MISSISSIPPI	10000		23360	233.60%
MISSOURI	129000		45910	35.59%
MONTANA	36000		N/A	
NEBRASKA	2000		11540	577.00%
NEVADA	34000		12800	37.65%
NEW HAMPSHIRE			N/A	
NEW JERSEY			107130	
NEW MEXICO	58000		12050	20.78%
NEW YORK			178300	
NORTH CAROLINA	107000	66000	47300	44.21%
NORTH DAKOTA	38000	46000	6070	15.97%
OHIO	271000		101100	37.31%
OKLAHOMA	275000	135000	21600	7.85%
OREGON	30000		N/A	
PENNSYLVANIA			127790	
RHODE ISLAND			11040	
SOUTH CAROLINA	64000		29620	46.28%
SOUTH DAKOTA	43000	43000	6110	14.21%
TENNESSEE			49070	
TEXAS	1508000	1933000	180990	12.00%
UTAH	83000	30000	16230	19.55%
VERMONT			4200	
VIRGINIA			56060	
WASHINGTON	17000		68580	403.41%
WEST VIRGINIA	10000	10000	16200	162.00%
WISCONSIN			44780	
WYOMING			2790	

Source: Multistate Tax Commission (ACIR numbers), NGA, 1987 Fiscal Survey of the States.

* Figures unadjusted for nexus and de minimus provisions.

ARKANSAS FURNITURE Association

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Ray Fureigh
Jim Edwards
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November 5, 1987

Honorable Max Baucus
Chairman
Senate Finance Committee
704 Hart Senate Office Building
Washington, D.C. 20510-2602

Dear Senator Baucus:

May we urge the Finance committee's support for-
S639 and S1099

States would benefit through increased sales tax revenues.

U. S. citizens would benefit because reduced pressure for state revenues could mean a lesser likelihood of increased state taxes.

Traditional retail businesses would benefit by equalizing competition from catalog and mail order houses.

Many businesses including J.C. Penney and other retailers who also do mail order are already collecting the sales tax for their mail order businesses and are thriving. They are not suffering from the allegeded administrative burden of collecting the sales tax on mail order purchases.

Everyone wins. No one loses. Please support Equity in Interstate Competition.

Sincerely,

Les Finch
Executive Director

LF/so

324 ROCK STREET, LITTLE ROCK, ARKANSAS 72202, (501) 375-3091

Harriet Carter GIFTS, INC.

STUMP ROAD
MONTGOMERYVILLE, PA 18936
TELEPHONE 215-361-5100

Distinctive Gifts From the World Over

October 28, 1987

Ms. Laura Wilcox
Senate Finance Committee
Dirksen Office Building
Washington, D.C. 20510

Dear Ms. Wilcox:

Thank you for talking to me yesterday. U.S. S.B. 639 which would require us to collect sales tax for 45 states in which we have no presence would be a disaster for our company and the rest of the mail order industry.

It is difficult and costly for any retailer to collect taxes from the public. It is exceedingly more difficult to collect taxes through the mail than at a store's cash register. Our average order is $28.00, sales tax at 6% (Pa. rate) amounts to $1.68. Our experience in Penna. indicates that only 80% of our customers send in the tax with their remittances. We have found it less expensive to pay the tax for the other 20% ourselves, rather than attempt to collect small amounts from our customers. Since our Penna. sales represent only a small percentage of our total volume, this does not represent a significant hardship. However, if this 20% figure is extended nationwide, the amount of tax due but unpaid by our customers would be an unbearable expense for us.

It is just not fair to require us to collect taxes for states where we receive no benefits. There seems to be a mistaken belief that computers can do it all. That they can simplify the collection and reporting for 45 additional jurisdictions monthly, each with its own exemptions, qualifications and regulations. This is nonsense. An entire additional staff is required in addition to expensive catalog space being needed to explain to our customers the "patchwork quilt" of rates and exemptions.

U.S. S.B. 639 is not in the national interest. Direct marketing provides convenience and savings to millions of Americans and jobs for tens of thousands. The requirements of the proposed legislation would not only threaten our continued existence as a viable employer of 350 people, but that of the entire mail order industry.

I would greatly appreciate your presenting this information to the Senate Finance Committee. Thank you.

Very truly yours,

Ronald P. Lassin
President

RPL/aw

Forestry Suppliers, Inc.

Forestry Suppliers, Inc. is a mail-order business, domiciled and chartered in Mississippi, selling professional equipment and supplies to customers in all fifty of the United States, plus to many international buyers. Our United States customers include Federal, state, county and city governmental agencies, schools at all levels of curriculum, industrial and commercial firms, and individuals.

Forestry Suppliers, Inc. has had actual interstate sales tax collection experience. For several years, terminating December 1979, we served as collecting agent for twelve states (AL, AR, CA, FL, GA, IN, KY, LA, MS, PA, SC, TN). The duties were burdensome, costly to us, full of difficulties, aggravating, administratively chaotic, principally because of unclear, frequently changed and widely-differing state laws and regulations. Exemptions from the payment of state sales taxes caused the most trouble.

Taxpayer exemptions came in many forms. As example, most states exempted schools from payment of state sales taxes, but not all did. Certain non-governmental customers were exempt from payment of state sales taxes because they had arranged to pay use taxes in lieu thereof. Frequently, however, those customers forgot, or neglected, to so inform us. The result was costly communication, clarification and refunding. The burden of correct tax determination, collection and remittance always pressed on Forestry Suppliers, Inc., not on the customer.

Merchandise exempt from sales tax varied widely among the twelve taxing states. A product exempt in one state was likely taxed in another. Some states linked tax liability to product use. As example, herbicides, in some states, would be subject to tax if used for non-farm purposes; otherwise exempt. How could we, the supplier, know the ultimate use? Our ignorance did not lessen our tax liability.

Fulfilling the obligations imposed upon us by the taxing agencies of twelve states was harmful to our business, injurious to good customer relations, costly to us in both money and time. Furthermore, the efforts on our part were not productive of many tax dollars.

We at Forestry Suppliers, Inc. sincerely want you to clearly understand the traumas we endured in our earlier interstate sales tax collection experiences. We feel that you, when aware of the difficulties, can arrange future legislation to be fair. To merely authorize the states to require mail-order businesses to collect interstate sales taxes does nothing to clarify, or avoid, the complexities created by individual state actions.

Passage of S. 639 and/or S. 1099, as now worded, would result, we feel, in many complexities, some judicial, some administrative, some financial, but mostly all unfair to mail-order businesses. Neither S. 639 nor S. 1099 addresses the complexity of nexus, the intangible connection of the taxing state and the non-resident mail-order business. Without a clear, constitutionally sound, presence in the customer's state? What nexus is there? What has the customer's state done to help the mail-order business? The 14th Amendment to the U.S. Constitution prohibits states from imposing a tax on individuals without giving them representation or without providing a viable service. True, the tax is assessed and is to be paid by the mail-order customer in the taxing state. Nonetheless, there will be sales in which the mail-order business will be unable to collect the tax, and will have to remit out of its own profits. There is no benefit to the mail-order business resultant from its conscription as a tax collector.

S. 639 and S. 1099 propose to convey to the states a regulatory power over interstate commerce. Is not such regulatory power solely reserved to Congress? This question was ruled upon in 1967 by the U.S. Supreme Court in the National Bellas Hess case. No facts have changed. Forcing mail-order businesses into

becoming interstate sales tax collection agents was ruled wrongful in 1967. It must be still wrongful today.

As S. 639 and S. 1099 are now worded, each leaves much undefined, and unresolved, subject to different interpretations and subject to different regulations in each of the sales-tax-levying states. Needed is:

1. A uniform nationwide, clear and acceptable definition of "tangible personal property".

2. A clear, agreeable answer to the question, "What constitutes a taxable sale?" In our earlier interstate sales tax collection experiences, exemptions from the payment of state sales taxes caused us the most trouble. Each state had its own laws that determined who and what products for what use were taxable. Is it fair to impose on mail-order businesses the burden of determining who and what is taxable in as many as fifty states? No such burden is carried by single-state retailers.

3. A uniform nationwide, acceptable definition of "tax-exempt customer". In our prior collection experiences, each state had its own version of exempt taxpayers. In some states a particular agency or organization was exempt from state sales tax. In other states that same agency or organization was taxed. As example, most states exempted schools from the payment of state sales taxes, but not all states did. Certain non-governmental customers were exempt from payment of state sales taxes because they had arranged to pay use tax in lieu thereof. Frequently, however, those customers forgot or neglected to so inform us. The result was costly, labor-intensive, time-consuming clarification.

4. A uniform nationwide, acceptable definition of a "tax exempt product" based on the nature or use of that product. A product, such as herbicide, may be taxable in certain states, non-taxable in some, and taxable or non-taxable in some states depending upon its use. For example, herbicides for farm use might be tax exempt, but herbicides in forest use might not be.

5. A clarification of who pays the sales tax. If a Purchase Order issued in state "A" (which has no sales tax law) directs the merchandise to be shipped to an address in state "B" (which imposes a sales tax), who pays the tax? The law needs to clarify such difficulties. When the mail-order business must do so, the procedures are costly, harmful to customer relations and to business.

These additional questions arise in considering S. 639 and/or S. 1099.

A. Will each state be empowered to alter at its pleasure the sales tax percentage rates, and the regulations for payment and collection? Will not such authority permit unfair treatment of mail-order businesses by taxing states? Single-state retailers abide by single-state laws. Mail-order businesses are being made subservient to the laws of up to fifty states.

B. What services will the taxing states perform for the mail-order businesses who serve as tax-collecting agents? The collection of one dollar in sales tax is reported to cost the mail-order business nearly seven times as much as such collection does a single-state retailer. Is such a large difference not discriminatory against mail-order businesses? Clearly, the mail-order business is performing a service for the taxing state. The expense of doing so is much greater for the mail-order business than for the single-state retailer. What, in return, is the taxing state doing for the mail-order business?

C. What cooperation, if any, with the mail-order business will the law require of the taxing state. Past experience

shows the states to be good at sending tax remittance forms; poor at keeping tax-collecting agents informed of changes in tax laws. The relationship should be mutually supporting: "You do for me; I do for you."

D. Will the law provide tolerance to the mail-order businesses in notifying customers of sales tax liability? Mail-order businesses use catalogs and other printed material to carry the message. Such material requires time to prepare, is usually printed in large quantities. Last-minute tax actions by states may be impossible to include, must await the next printing. The mail-order business needs a tolerance time during which it is protected from state penalties.

E. Mail-order businesses must inform customers of applicable tax laws. Printing and postage is costly. By contrast, a single-state retailer has no tax notification cost. The state, through newspaper and electronic media, disseminates any changes in the state laws. Is it only fair to appropriately compensate mail-order businesses for these added costs?

F. How will a mail-order business initiate, or terminate, its activity as a sales tax collection agent? S. 1099 establishes a nationwide dollar sales volume level, below which a mail-order business is exempt from the law's provisions. Assume that a mail-order business reaches the sales level in November. Does it immediately commence collecting? Must the mail-order business broadcast to the states its sales level?

Conversely, suppose the mail-order business prospers, becomes an established collector, then falters and falls below the minimum sales volume. How does it terminate? Does the state refund to the mail-order business sales taxes paid after the falter? Does the mail-order company refund taxes to individual customers?

Evident it is that the effects of requiring mail-order businesses to collect interstate sales taxes can become very, very complicated.

Evident it is, also, that without clear, fair, equitable Federal standards to which the taxing states must adhere, the states can kill the mail-order business industry. What may have been considered an easy, painless way to increase tax revenues may be found complex, and not practical. The parable of the goose that laid the golden eggs can become a real-life tragedy.

The mail-order business industry is vital to the economy of the United States. A mail-order business is the roadway to market for thousands of entrepreneurs. Through mail-order all types of businesses can launch products in a test of market acceptance. If the market response warrants, product distribution can be broadened to include single-state retailers.

Mail-order is the artery of the crucial merchandise, the little bits and pieces, without which the big economic machine would gasp and die. True, there are large national businesses that sell everyday merchandise also offered in retail stores. Many of these large mail-order businesses already operate retail stores in many states and already collect state sales taxes. These businesses also aid the economy by making merchandise easily available to customers without store-to-store searching, thus adding to workers' productive time. Thousands of smaller mail-order businesses can function only as mail-order. The volume of business is too small to support a walk-in retail store anywhere. Millions of United States citizens are dependent upon mail-order businesses for much of their needs. Age, infirmities and physical location (lack of access to stores) make mail-order essential.

Mail-order businesses have increased in number and their sales volume has grown because they have provided a service not otherwise available. Any legislation that unfairly discriminates against mail-order businesses reduces their ability

to properly serve their customers. The deleterious effects therefrom will soon be felt throughout the national economy.

Congress may deem it mandatory that the mail-order customer pay sales taxes. In such event, would it not be wiser and more practical to impose a nationwide Federal Mail-Order Sales Tax? Establish one percentage rate, uniform nationwide. Apply the tax to every customer on anything sold by every mail-order business. Authorize the mail-order business to collect the tax, and remit the proceeds to the U.S. Treasury, which would disburse to the states proportionate to the amount of mail-order sales from each.

A Federal Mail-Order Sales Tax would free the states and the mail-order businesses from a burdensome administrative load, would provide revenue to the taxing states, would be easy to audit.

Would not a Federal Mail-Order Sales Tax be fairer to all than granting unrestrained taxing power to the states?

We hope very much that what we have offered above will be helpful. We invite your call or correspondence whenever you feel we may be further helpful.

Phone, FAX, Telex or write to:

Forestry Suppliers, Inc.
205 W. Rankin Street
Post Office Box 8397
Jackson, Mississippi 39204-0397
Telephone: 1-601-354-3565
FAX: 601-355-5126
Telex: 585330 FORSUP INC.

END

JWC:jf

HEATH COMPANY
BENTON HARBOR, MICHIGAN 49022

William E. Johnson
President

November 19, 1987

Finance Subcommittee on Taxation
and Debt Management
United States Senate
205 Dirksen Building
Washington, D.C. 20510

Subject: Hearing on the Collection of State Sales and Use Taxes by Out-of-State Vendors
Bills S.639 and S.1099

Gentlemen:

I'm writing to voice strong opposition to proposed bills S.639 and S.1099 for the following reasons:

1. Passage of this legislation would drastically limit the competitiveness of mail order marketing firms in this country.

   The mail order marketing channel has for many decades proven to be an efficient and effective way to market products by enabling consumers to place orders from the convenience of their homes. Companies involved in mail order marketing provide a valuable alternative to the customer who does not or cannot purchase items through local retail stores.

2. The mail order customer must pay postage or freight charges to receive the product (retail customers do not pay such postage/freight costs).

3. The mail order purchaser must wait several days for delivery of the product and often chooses to order by mail in order to share in the savings associated with centralized warehousing and efficient mail order handling procedures.

4. Individual states are looking to this form of tax in desperation to fill their revenue coffers depleted by overspending, bureaucracy and waste.

5. The cost to collect these taxes would be huge and uniform enforcement practically impossible.

6. This burdensome tax on interstate mail order companies would drive many direct marketing firms out of business as it would effectively raise prices of their products by anywhere from 4 to 8% (depending upon state sales tax rates). Customers would simply not pay freight charges, wait several days or weeks for the product and then pay sales tax in addition.

7. Administrative costs of tracking numerous sales tax rates in different states will require burdensome overhead on every mail order company.

8. States could well find that the loss of tax revenue from the demise of mail order companies within their borders will be far more than gains anticipated from imposition of the proposed interstate mail order tax.

The mail order business of Heath Company dates back to the early 1930's. We have served literally millions of customers over that period of time with high integrity. Due to continually rising costs associated with paper, printing and postage we are now operating on razor-thin margin. Should the proposed bills be enacted it is almost certain our mail order business would close, as it is impossible for us to absorb state sales taxes, and we know that a 5 or 10% increased price to our customers would have a devastating effect on sales. I believe it's safe to say the 40 year old Heathkit mail order business will close its doors if this legislation is enacted.

I implore you to not pass the law that will bankrupt a large number of this country's mail order companies and put thousands of loyal employees out of work.

Yes, the individual states either need more revenue or better management of existing revenues. I suggest the latter is far more fertile territory.

Sincerely,

William E. Johnson

William E. Johnson
President

WEJ/rs
cc: Senate Finance Committee
House Judiciary Committee
Select Revenue Measures Subcommittee
of the House Ways and Means Committee

STATE OF INDIANA

DEPARTMENT OF REVENUE
OFFICE OF COMMISSIONER
202 STATE OFFICE BUILDING

INDIANAPOLIS, 46204-2253

STATEMENT SUBMITTED TO
THE SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
BY THE INDIANA DEPARTMENT OF STATE REVENUE,
FOR HEARING ON S.1099 and S.639

November 6, 1987

I am writing to express my continuing support of S.1099 and for the objectives of S.639. This deals with what is commonly known as the National Bellas Hess issue.

This proposed legislation would correct the National Bellas Hess decision which, since 1967, has precluded states from requiring the collection of sales tax on sales by companies that do not have a "physical presence" in the destination state. This concerns the growing industry of mail order vendors. This approach would authorize states to require the collection of sales tax on interstate sales when the sale is destined to the taxing state.

I concur with the statement of the National Association of Tax Administrators (NATA). This legislation is generally accepted by state administrators as the appropriate cure to this ongoing problem. Our most recent study indicates Indiana is losing between $36 million and $46 million in sales tax revenue each year. In addition, Indiana vendors who correctly collect the tax must compete with out-of-state vendors who do not collect the tax.

Respectfully submitted,

M. F. Renner,
Commissioner
November 18, 1987

Contact:
James D. Mundt
Deputy Commissioner
Indiana Department of
Revenue
(317) 232-2105

Honorable Max Baucus
United States Senate
Washington, D. C.

Dear Mr. Chairman:

In behalf of the Magazine Publishers Association, I write to express our views on S. 639 and S. 1099, the subject of hearings before your Subcommittee on Taxation and Debt Management.

The Magazine Publishers Association is a national organization representing 217 publishing houses that publish more than 800 consumer interest magazines in the United States. MPA membership includes weekly news magazines and a wide variety of publications covering the interests of the American people -- art, literature, science, sports, politics, crafts, hobbies, homemaking, and many others. Ninety percent of all subscriptions sold in the United States are sold by mail order solicitation and response; they account for about 150 million subscriptions annually.

Mail order subscriptions are particularly prevalent outside of major metropolitan areas where newsstands are few in number and sometimes carry a limited number of publications. Small circulation magazines -- journals of opinion, specialized publications like Successful Farming or Foreign Affairs, as well as magazines that carry little advertising -- rely on subscription revenues for most of their income. So any legislation or administrative action that threatens to impose a greater cost burden on the publisher is of utmost concern them, and to the magazine publishing industry generally.

S. 639 and S. 1099 would permit states to impose and collect sales or use taxes on the sale of property by means of interstate sales even though the seller has no physical presence in the state. For instance, a state could require a publisher located outside the state to collect the state sales or use tax on a mail order subscription sale, even though the publisher's only connection with the state is his use of the United States Postal Service to solicit and receive mail order subscriptions. We oppose the legislation.

If enacted, this legislation would permit states to impose sales taxes on the media -- magazines and newspapers sold in interstate commerce. To recover that cost, the publishers would attempt to pass the burden on to advertisers or subscribers, or both. Collecting the tax and paying multiple jurisdictions would be an extra cost and that burden, too, would have to be passed on -- either that or the publisher's profits would suffer. In cases where advertising revenue is limited, subscription prices would have to be increased to pay the added cost, and circulation would be adversely affected. Studies of cost impact consistently show that when subscription prices go up, fewer people subscribe; sales decline in almost direct proportion to cost increases.

The authority of state governments to tax foreign businesses has a long history. The present state of the law is that in order for a state to tax a foreign business, the business must maintain some tangible presence in the state -- a retail store, a warehouse, a salesman, an office -- something that fits the legal concept called "nexus." In 1967, the Supreme Court considered whether "nexus" (and therefore tax liability) existed when the only contact between the seller and the state was the seller's use of the postal system. That case, National Bellas Hess v. Illinois, 386 U.S. 753, dealt with Illinois' statutory requirement that a mail order house collect the Illinois sales tax, and whether that requirement violated the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of Article I

of the Constitution. The Court said that it did. The Commerce Clause, the Court concluded, required "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." Such a connection was not present, the Court said, where the only "link" was the use of the United States mails. "Indeed," the Court said,

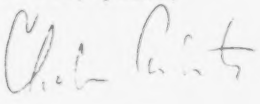
> It is difficult to conceive commercial transactions more exclusively interstate in character than the mail order transactions here involved. And if the power of Illinois to impose use tax burdens upon National were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. 386 U.S. 759.

We believe the distinction set forth in National Bellas Hess is good public policy. It requires an affirmative answer to the key question, "Has the State given anything for which it can ask return?" Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1941). Where the only presence of a business enterprise in a State is in a customer's mail box, the answer is "no." There is no police protection, no public service, no benefit whatsoever to the seller, because the seller is not there. States cannot take credit for the United States mails. To change the law, to overrule National Bellas Hess, really does mean "Taxation Without Representation." That may sound melodramatic, but our Forefathers who rebelled against the Townsend Acts received far more protection from George III than any publisher receives from a state on the other end of a Zip Code.

The Interstate Commerce Clause is in the Constitution for good reason. It is an essential ingredient in the Constitution that makes America a Nation rather than a confederation. The balance of Federal-State powers achieved over two centuries built the Nation. Surrendering to the states the power to tax interstate commerce, to tax where the state has given nothing, is inconsistent with that national principle. Yet that is what these bills do: they tell the states that they may tax a transaction on the basis of "nexus" fabricated out of thin air and a post office box.

Twenty-two years ago, the Committee on the Judiciary of the House of Representatives examined in depth state sales and use taxes and found the subject "exceedingly troublesome." The Committee said "the task of making the sales tax effective and workable inevitably falls upon the Congress." House Report 565, 89th Congress, 895 (1965) We agree. The proposed legislation is complex, costly, and most of all, inherently unfair. We are opposed, and we hope that your subcommittee will not take favorable action.

Sincerely yours,



STATEMENT SUBMITTED TO
THE SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT BY BRAD DYE, LIEUTENANT GOVERNOR; C. B. (BUDDIE) NEWMAN, SPEAKER OF THE HOUSE OF REPRESENTATIVES; H. L. "SONNY" MERIDETH, JR., CHAIRMAN OF WAYS AND MEANS COMMITTEE; AND C. ROBERT MONTGOMERY, CHAIRMAN OF FINANCE COMMITTEE, OF THE STATE OF MISSISSIPPI, FOR INCLUSION IN THE PRINTED RECORD OF THE HEARING ON S. 639 AND S. 1099.

We submit this statement in support of legislation regarding the collection of state sales and use taxes by out-of-state vendors. Legislation reversing the National Bellas Hess decision would correct the competitive disadvantage suffered by local retailers and would allow the states to collect needed revenues and avoid further erosion of their tax base.

Mississippi relies heavily on state sales and use tax revenues to fund state government and to provide funds to local governments. In fact, sales and use taxes account for sixty-two percent (62%) of total state tax collections. Our sales and use tax general rate has been increased twice since 1983 to six percent (6%). In 1983, our income tax rates for individuals and corporations were increased, and since 1983 tax rates have been increased on alcoholic beverages, automobile tags, beer, cigarettes, motor fuels and certain sales tax items not subject to the general tax rate. In 1986, the Legislature enacted legislation to temporarily freeze the hiring of state employees and to implement state government cost savings programs, such as an early retirement incentive program, a centralized printing shop, a tax amnesty program and other programs designed to reduce expenditures and to authorize or increase fees for certain government services. Additionally, state bonds have been authorized by the Legislature to finance highways, prisons and industrial development projects. In three of the last six fiscal years revenues have fallen below projected expenditures, necessitating budget cuts in state agencies and programs. Thus, exercising fiscal responsibility has been addressed by raising taxes and reducing budgets. We feel that the tax burden placed on our taxpayers is significant; therefore, we are compelled to look within our existing tax structure for additional sources of revenue, particularly in view of anticipated losses of federal funds. Unwarranted tax exemptions such as those enjoyed by out-of-state vendors must be removed.

The Advisory Commission on Intergovernmental Relations conservatively estimates that Mississippi will lose approximately $23.4 Million in the 1988

fiscal year as a result of tax exempt mail order sales. The National Conference of State Legislatures has stated that over fourteen percent (14%) of all retail sales are now made by out-of-state direct sellers and the National Association of Tax Administrators estimates that sales through some sort of interstate transactions could reach twenty-five percent (25%) of all retail sales. Increasing sales that escape taxation could have a very detrimental impact on our tax base and to jobs in Mississippi.

S. 1099 contains two threshold provisions. One provision exempts persons below a specified level of gross sales in the United States from collecting the tax and the other provision exempts persons below a specified level of gross sales in the state from collecting the tax. We don't disagree with a mechanism to minimize compliance costs, but we are concerned about any threshold based upon sales to a particular state because this allows transactions in wealthier states to be taxable while sales to individuals in poorer states would escape taxation; thus the states in greatest need would be deprived of needed income.

We appreciate the opportunity to express our views in support of legislation to require out-of-state vendors to collect legally due sales and use taxes.

Brad Dye

C. B. (Buddie) Newman

C. Robert Montgomery

H. L. "Sonny" Merideth, Jr.

Multistate Tax Commission

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December 3, 1987

Ms. Laura Wilcox
Hearings Administrator
Senate Finance Committee
United States Senate
Washington, DC 20510

Dear Ms. Wilcox:

Enclosed for submission is a written statement for the printed record of the hearing on the collection of state sales and use taxes by out-of-state vendors. This written statement is in response to the oral testimony made by Professor Lucas Powe about the constitutional issues of reversing the National Bellas Hess decision.

The Multistate Tax Commission disagrees with Professor Powe's contention that pending legislation to reverse the National Bellas Hess decision will prove unconstitutional. In particular, our written statement presents three major differences of opinion with his statement. They are:

1. The National Bellas Hess v. Illinois Department of Revenue decision was made based only on the facts of the case. The Supreme Court did not rule on broader issues of interstate solicitation.

2. The Supreme Court appears to have based its decision upon the Commerce Clause and not upon the Due Process Clause as represented by Professor Powe.

3. Professor Powe's arguments rely upon review of the law from the 1950s through the mid-1970s and do not consider more current Supreme Court decisions in the area of the states' personal jurisidiction.

The consideration of the Senate Finance Committee of our written statement is appreciated. We are confident you will find a strong constitutional case for allowing states to collect the sales tax from out-of-state vendors.

Sincerely yours,

Alan Friedman
Acting Executive Director

My name is Alan H. Friedman, Acting Executive Director and Deputy General Counsel for the Multistate Tax Commission. The Senate Finance Subcommittee on Taxation and Debt Management has received testimony from our organization on the sixth of November, 1987 through the joint testimony of John Baldwin,

President of NATA and Hal Hansen, Chairman of the Multistate Tax Commission.

The Subcommittee heard the testimony of Professor Lucas Powe with regard to his view as to the constitutionality of pending legislation that would reverse the major thrust of the case of National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 753 (1967). The following is a short response to Professor Powe and provides a contrasting view of the law in this area to that which he presented.

In reading Professor Powe's testimony, I was somewhat taken aback by the manner by which he reached the conclusion that current Congressional efforts to reverse the National Bellas Hess case were unconstitutional. Professor Powe states that it is "all but certain that the two bills in question would be quickly declared unconstitutional in whole (H.R. 1891) or in part (H.R. 1242)." The Senate version of H.R. 1891 is now before your Committee as S. 1099. A closer examination of such a bald statement by Professor Powe should place it in its proper perspective - that of but one lawyer's opinion. Other legal authorities would likely disagree with Professor Powe.

Over thirty years ago, Paul Hartman, Professor Emeritus, Vanderbilt University, clearly suggested that along with new methods of marketing goods, the Supreme Court should develop new approaches regarding its concept of "nexus" in the area of interstate sales. Professor Hartman stated:

> "With the great expansion of ways of merchandising vastly different from those when the Court developed many of its ideas of due process, perhaps there should be a revamping of the notion of what constitutes sufficient "nexus" to satisfy due process, as well as what the commerce clause will permit by way of state taxation. Should not the exploitation of a state's markets for the capture of profits be enough for that state to demand something in return, thus satisfying the requisites of the due process clause? Several hundred travelling salesmen, no matter how avidly they hawk their wares, are not nearly as effective a "nexus" for an exploitation or invasion of a consumer market as a Dinah Shore or a Pat Boone as they croon their sponsor's products into the hands of thousands of purchasers on interstate television and radio. Is the state of market to be denied a tax from either the out-of-state seller or the broadcasting company because the contacts of such out-of-state sellers and broadcasters are ethereal only? Or, should a well known milk company be permitted to milk the consumer market with the sonorous singing of ballads by hillfolk and western singers without paying its tithe to the state of market on the ground that the interstate radio and television milking process is too ethereal?"[1]

Professor Hartman has again, more recently, expressed this view in his treatise on the subject of state and local taxation. Professor Hartman states that:

> ".....Benefits from the taxing state, unrelated to physical contact with the State, may be of vastly greater significance than those derived from the presence of a whole swarm of drummers soliciting business. Practically speaking, it is hardly essential to the existence of a nexus with the taxing State that there must be personnel, directly engaged in some form of physical activity within the State in furtherance of a business purpose. The connection between the taxing State and the out-of-state collector-seller to establish nexus should be an economic rather than a physical relationship. When the out-of-state seller takes advantage of the economic milieu within the taxing State for the purpose of realizing a profit, a sufficient nexus to require the seller to collect the use tax could be found....".[2]

In order for the record to be clear on this point, other legal authorities would also disagree with Professor Powe's conclusions. In order to gain a better insight than can be provided in this short statement, I refer the Committee to recent law review treatments of the subject for fuller expositions concerning the issue.[3]

Professor Powe appears also not to have perceived what the Supreme Court in fact held in its National Bellas Hess decision. After first setting up the description of the Illinois' use tax statute in issue as requiring "'firms soliciting orders within this State from users by means of catalogues or other advertising' to collect the tax", Professor Powe then misstates the holding of the decision by stating that the "Supreme Court held that the Illinois requirement violated both the Commerce Clause and the Due Process Clause." Testimony of Powe, p.2. Professor Powe's description of the case is not correct in at least two important respects.

First, the Illinois statute requiring use tax collection was not held unconstitutional on its face as implied by Professor Powe; but it was determined to be unconstitutional as applied to the facts of the case - two bulk mailings into Illinois, followed by the occasional mailing of flyers and the delivery by mail or common carrier of the goods purchased. The Supreme Court did not rule upon any other type or degree of interstate solicitation than that presented by the facts before it.

The second point, and most important to the Congressional effort, is that the Supreme Court appears to have based its National Bellas Hess ruling upon the Commerce Clause, and not the Due Process Clause as represented by Professor Powe. The official syllabus of the case that was prepared by the Reporter of Decisions for the Supreme Court opinions, while not controlling, clearly states that the Court's decision was based upon the Commerce Clause and not the Due Process Clause. Professor Powe, having been law clerk to Justice White, certainly is aware of the

practice of the Justices or their law clerks to read the syllabi before publication of the opinions. In the National Bellas Hess case, the syllabus provides, in pertinent part, as follows:

> "Held: The Commerce Clause prohibits a State from imposing the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or by mail." (Emphasis added).[4]

The National Bellas Hess Court was very concerned about the effect upon interstate sellers of the "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements." National Bellas Hess 759. It was those concerns that led the Court to find, on Commerce Clause grounds, that Illinois' attempt to apply its statute to National Bellas Hess violated the purpose of the Commerce Clause "to ensure a national economy free from such local entanglements." Id. 760.

The primary reason for Professor Powe's failure to view the proposed legislation as a constitutional exercise of Congressional power is that his vision of what the law is results from his looking backward as to what the law was from the 1950's through the mid- 1970's and being overly influenced by it. He fails to view the current validity and scope of the National Bellas Hess decision in circumstances that exist in the 1980's and completely ignores the recent evolution of Supreme Court case law in the area of personal jurisdiction. While Professor Powe may not want to recognize the revolutionary manner by which business enterprises currently conduct their interstate activities, the Supreme Court has recently considered such evolution in the context of deciding the reach of the states' personal jurisdiction. Recent cases, such as Asahi Metal Industry Co., Ltd. v. Superior Court of California, ___ U.S. ___, 107 S. Ct. 1026 (1987); Tyler Pipe Industries, Inc. v. Washington Department of Revenue, ___ U.S. ___ Nos. 85-1963 and 85-2007 (slip.op. June 23, 1987); Burger King v. Rudzewicz, 471 U.S. 462 (1985); and Keeton v. Hustler Magazine, Inc., 465 U.S. 770 (1984), when considered with the watershed case of Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), create a new set of analytical tools with which to labor in the area of nexus determinations.

The Complete Auto Transit decision made clear that state taxation imposed directly upon interstate sales does not violate the Commerce Clause of the Constitution when such activity has a sufficient connection with the state; is fairly apportioned; does not discriminate against interstate commerce; and is fairly related to the benefits provided the taxpayer. When viewed under

this standard, the direct marketer that regularly or systematically solicits a state's consumer base should be accountable to the extent of collecting the taxpayer/consumer's use tax obligation.

The Tyler Pipe case held, in part, that the activities of independent contractors created nexus over the taxpayer. This is not a new proposition in the sales and use tax area. See Scripto, Inc. v. Carson, 362 U.S. 207 (1960)). But in Tyler Pipe, the Court specifically approved the statement by the Washington Supreme Court regarding nexus as follows:

> "As the Washington Supreme Court determined, `the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.'" Tyler, slip. op., p.1.

While the above-quoted language may be considered possible dictum in the context of the opinion, that language may shed some current light on the Court's modern approach to nexus questions, especially in light of the discussion below concerning where the Court appears to be headed with respect to issues of personal jurisdiction.

In Keeton, the Supreme Court held, in a libel action, that the defendant magazine publisher was subject to personal jurisdiction, consistent with due process, in a state in which its only contact was the circulation of its magazines that had been aimed at a nationwide audience.

In the Burger King case, the Supreme Court clearly recognized that physical presence is not a prerequisite for personal jurisdiction. It stated that jurisdiction -

> "... may not be avoided merely because the defendant did not physically enter the forum state. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a state in which business is conducted. So long as a commercial actor's efforts are `purposefully directed' toward residents of another state, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction."

In Asahi, in holding a foreign manufacturer not subject to suit in the U.S. on the facts presented, the Court re-enforced its position that jurisdiction will rest upon a substantial connection being created by a defendant's action that is

"purposefully directed toward the forum state." Asahi, slip op., p. 8. What is most instructive about the Asahi case is Justice Brennan's concurring opinion in which Justices White, Marshall and Blackmun joined. These four Justices would find personal jurisdiction consistent with due process notions solely upon a defendant's awareness that the stream of commerce may or will eventually deliver its product into the forum state -

> "... The stream of commerce refers not to unpredictable currents or eddies, but to the regular and anticipated flow of products from manufacture to distribution to retail sale. As long as a participant in this process is aware that the final product is being marketed in the forum State, the possibility of a lawsuit there cannot come as a surprise. Nor will the litigation present a burden for which there is no corresponding benefit. A defendant who has placed goods in the stream of commerce benefits economically from the retail sale of the final product in the forum State, and indirectly benefits from the State's laws that regulate and facilitate commercial activity. The benefits accrue regardless of whether that participant directly conducts business in the forum State, or engages in additional conduct directed toward that State. Accordingly, most courts and commentators have found that jurisdiction premised on the placement of a product into the stream of commerce is consistent with the Due Process Clause, and have not required a showing of additional conduct." (Emphasis supplied) Id. at 4201.

The Supreme Court has early on determined that the jurisdiction to tax a person is closely associated with the judicial jurisdiction of the state over that person. See Shaffer v. Carter, 252 U.S. 37 (1920) wherein the Court held that ..."[g]overnmental jurisdiction in matters of taxation, as in the exercise of the judicial function, depends upon the power to enforce the mandate of the State by action taken within its borders, either in personam or in rem ...". Given the recent United States Supreme Court cases that extend personal jurisdiction due process concepts to those that "purposefully" direct their marketing efforts into a state, the issue of whether out-of-state marketers that use regular or systematic methods of interstate solicitation should be required to collect the use tax is ripe for review both by Congress and the judiciary. The resolution of that issue, when considered in light of modern marketing techniques and the ability to respond by computer to the added record keeping burden, is far from being as clear as Professor Powe would have the Committee believe.

Professor Powe concluded his testimony by stating that "The Court's holdings are clear and in these circumstances the constitution requires a vote against bills that run directly counter to the Court's holdings." I suggest that Professor Powe's

sense of what is "clear" is somewhat out of focus from opinions held by others. And, finally, his suggestion that any member of Congress who votes in support of any of the pending bills violates his or her oath of office is without reason or foundation. The Multistate Tax Commission, therefore, respectfully urges your support of the pending legislation.

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[1] Hartman, State Taxation of Corporate Income From A Multistate Business, 13 Vand. L. Rev. 21, 13.

[2] P. Hartman, Federal Limitations on State and Local Taxation. 631 (1981). See also, Hartman, Collection of the Use Tax on Out-of-'state Mail-Order Sales, 39 Vand. L. Rev. 993 (1986).

[3] McCray, "Overturning Bellas Hess: Due Process Considerations, "Brigham Young Law Review, Vol.1985 No.2 (Summer 1985); McCray, "Commerce Clause Sanctions Against Taxation on Mail Order Sales: A Re-Evaluation," The Urban Lawyer, Vol. 17, No.3, (Summer 1985).

[4] See also, Hellerstein, State Taxation (1983) at page 226 at which it is stated that the Supreme Court's National Bellas Hess holding was based upon Commerce Clause language.

STATEMENT OF JOHN M. RECTOR

BEFORE THE SENATE FINANCE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

NOVEMBER 6, 1987

Mr. Chairman, Members of the Subcommittee*:

I am John M. Rector. I serve as General Counsel and Vice President of Government Affairs for the National Association of Retail Druggists.

The National Association of Retail Druggists represents the owners of nearly 40,000 independent pharmacies, where more than 75,000 pharmacists dispense 70 percent of the nation's prescription drugs. Together, they serve 18 million persons daily and provide 82 percent of Medicaid pharmaceutical services. Over 60 percent of NARD's members provide home health care pharmacy services.

NARD members are primarily family businesses. They have roots in America's communities. The neighborhood independent druggist typifies the reliability, stability, yet adventuresomeness that has made our country great.

As owners, managers and employees of independent pharmacies, our members are committed to legislative and regulatory initiatives designed to provide them a fair chance to compete. We appreciate the opportunity to appear before the Subcommittee to present our recommendations.

Competition in retail pharmacies is alive and well. Competition is an incentive for efficiency and the price competition in retail pharmacy is typically greater than can be found among other providers of health services and products.

We welcome competition and appear today to assist in the effort to assure that retail competitors confront one another on a level playing field.

We strongly endorse S.639 and S.1099 and their House companion H.R.1242, the "Interstate Sales Tax Collection Act of 1987", which would eliminate judicially imposed restrictions on the power of the states to collect taxes on interstate mail order sales.

In 1967, the U.S. Supreme Court in National Bellas Hess v. Illinois Department of Revenue in effect exempted out-of-state mail order businesses from the obligation of collecting taxes from the buyers of mail order goods and remitting the revenue to the home state, and/or city or local jurisdiction of the purchaser of the out-of-state mail order products. Texas, for example, loses more than $100 million in taxes annually. (See attachment A-1)

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* Max Baucus (D-Montana), Chairman
MAJORITY: (4-D) Senators: Baucus, Spark Matsunaga (D-HA), Daniel P. Moynihan (D-NY), David Pryor (D-AR)
MINORITY: (4-R) Senators: John H. Chafee (R-RI), William Roth Jr. (R-DE), John C.Danforth (R-MO), Malcolm Wallop (R-WY)

In effect, such sales have become defacto tax exempt: To the detriment of our members and other retailers who must reflect the tax due in the cost of products and must collect the tax for state and local jurisdictions, and to the detriment of the governmental jurisdiction that are deprived of additional revenue. This defacto tax exempt status yields an advantage to untaxed mail order firms ranging from 2.5 to more than 8 percent depending on the jurisdiction involved.

As mentioned at the outset, our members dispense 70% of all prescription drugs in the United States. Recent reports indicate that prescription drugs account for 60% (41.6 to 78.5%) of a typical NARD member's sales volume. Of course, as you are all familiar, the balance of our members' sales volume includes products such as over the counter drugs, health and beauty aids, sundries, greeting cards, gifts and related products.

Additionally, more than 50% of our members are involved with the sale or rental of home health care products ranging from high tech parenteral products to walkers. In all these product categories, we are confronted by profit and commercial nonprofit mail order competitors. Even a few nonprofit hospitals have entered the mail order drug business.

Most of the current focus in our industry is on mail order dispensing of prescription drugs. These tax exempt competitors (via defacto Bellas Hess or commercial nonprofits) are engaging in costly promotional efforts, in part made possible because they are able to evade state and local taxes. These interstate mail order businesses similarly are attempting to evade the application of state pharmacy practice and other public health laws.

In fact, the subcommittee on Oversight and Investigations of the Energy and Commerce Committee in its April 1986 report Dangerous Medicine recommended (at page 8) that the Congress should:

> "Closely examine the mail order dispensing of pharmaceuticals to determine whether or not the public health risks of this growing practice are reasonable."

We support the legislation principally because there should be a level playing field in the retail drugstore marketplace. We heartily endorse the comments of the Multistate Tax Commission on the more technical and general need for the legislation.

Commercial Nonprofits

We suggest that the subcommittee include commercial nonprofits within the definition of "retailer engaged in business in that state". We are aware that Chairman Rostenkowski and Oversight Subcommittee Chairman Pickle have made the revenue loss associated with the activities of commercial nonprofits a high priority for the 100th Congress. We recommend that such concerns be addressed in this legislation. The activities of commercial nonprofits are not substantially different from those for profit companies in the mail order retail drug marketplace. Both sell products available from commercial, for profit companies, our members, on a routine basis and routinely do not pay state and local taxes.

The AARP Pharmacy Services and the Arthritis Foundation are prototypical examples of commerical nonprofits in the mail order retail drug marketplace. They pitch savings and drugs at "prices below retail". Of course, exemption from state and local tax is just one of many subsidies they enjoy. AARP, for example, receives an annual federal postage subsidy of approximately $6,500,000 which is used to promote its retail

pharmacy as the number one benefit for AARP members. Especially revealing is that commercial nonprofits tend to focus activities in state with the highest tax rates.

Whether the advantage for tax evasion by profit or commercial nonprofits involved with mail order is 2.5 or 8%, it can be a critical competitive advantage in our marketplace where the net profit before taxes averages 2.8% of total sales. Each of these competitors enjoys the advantages of our competitive marketplace and should pay their share of the freight including the same taxes as other entrepreneurs. Just as the point is made with regard to foreign trade, all competitors in the marketplace should confront each other on a "level playing field". For any segment of the market to enjoy artificial advantages over its competitors strikes at the very foundation of the new enterprise system. These bills will help achieve this goal.

There is no doubt that the increase in mail order sales has diverted sales from members of the National Association of Retail Druggists who contribute service, convenience, property taxes, and charitable contributions to their communities. For the long-term survival of these and other small businesses, we urge you to put mail order sales on the same state and local tax basis as any other business. You can help keep small business and our local communities healthy by extending the taxing prerogative of the states to mail order sales.

On behalf of the Officers, Executive Committee, and members of the National Association of Retail Druggists, we thank you for the opportunity to appear and participate in the formulation of appropriate federal legislation on this matter.

FISCAL NOTES

Texas at a Glance:

Mail-Order Businesses

The State of Texas loses more than $100 million in taxes annually on sales made by 1,120 of the nation's biggest out-of-state mail-order retailers.

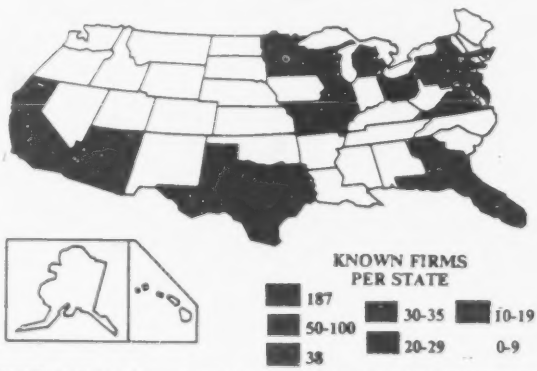
Tax is due on those sales, but the state cannot compel the out-of-staters to collect and remit it. By not collecting sales tax, the firms obtain a built-in six percent price advantage over local Texas merchants.

The biggest number of the companies is headquartered in New York. In 1985 that state had 187 mail-order firms, each with sales of more than $5 million. Illinois came next with 83 firms, followed by California with 73, Pennsylvania with 65 and New Jersey with 55.

Texas ranked sixth among states with 38 big mail-order retailers.

Legislation is pending in Congress that would let Texas get the money it's due and would even the odds between local retailers and their out-of-state competitors.

Mail-Order Businesses... Annual Sales of More Th[illegible]5 Million



SOURCE: Bob Bullock, Comptroller of Public Accounts, and *Mail Order Marketing Management Library.*

Projected State Revenue Losses From Mail-Order Sales, 1985

(in thousands of dollars)

State[1]	Estimated Range of Lost Revenues		Percentage of Projected 1985 Sales Tax Revenues
Alabama	[illegible]	[illegible]	[illegible]
Arizona	16,541	[illegible]	1.7-2.1
Arkansas	10,825	11,312	2.2-2.2
California	101,556	209,436	1.2-2.4
Colorado	8,901	15,012	1.3-2.1
Connecticut	10,932	14,472	0.8-2.7
District of Columbia	1,413	2,625	0.5-2.5
Florida	29,931	63,247	1.1-1.7
Georgia	22,896	45,934	1.7-2.7
Hawaii	421	6,416	0.1-0.9
Idaho	4,774	11,654	2.5-6.2
Illinois	81,022	89,263	2.2-3.3
Indiana	30,321	36,732	1.7-2.1
Iowa	16,243	20,785	2.5-3.2
Kansas	11,585	23,051	2.0-4.1
Kentucky	21,346	52,677	2.7-6.6
Louisiana	23,266	38,685	2.4-4.0
Maine	5,542	13,025	1.8-4.2
Maryland	23,806	63,408	2.4-3.6
Massachusetts	8,962	44,354	0.7-2.9
Michigan	39,784	42,792	1.8-1.9
Minnesota	30,174	63,241	2.7-2.9
Mississippi	16,241	44,715	1.9-5.1
Missouri	28,596	44,060	2.5-3.9
Nebraska	6,208	12,126	1.6-2.9
Nevada	6,503	10,517	1.6-2.5
New Jersey	16,914	58,095	0.9-3.1
New Mexico	8,176	22,527	1.5-4.1
New York	47,439	122,937	1.2-3.1
North Carolina	30,478	62,745	3.2-6.7
North Dakota	3,848	10,307	2.3-6.2
Ohio	38,183	61,960	1.7-2.7
Oklahoma	14,210	27,531	3.1-5.9
Pennsylvania	50,158	76,613	1.9-2.8
Rhode Island	886	6,053	0.4-2.5
South Carolina	18,810	29,709	2.4-3.8
South Dakota	3,512	7,867	1.8-4.0
Tennessee	36,864	72,583	2.7-5.4
Texas	97,407	101,020	2.6-2.7
Utah	10,045	10,238	2.3-2.3
Vermont	2,615	7,984	3.4-10.5
Virginia	27,660	36,842	4.5-4.6
Washington	49,132	61,027	1.8-2.2
West Virginia	11,001	18,161	1.3-4.5
Wisconsin	27,326	29,862	2.0-2.2
Wyoming	1,962	4,862	0.9-2.2

[1] *Alaska, Delaware, Montana, New Hampshire and Oregon have no state sales tax.*

SOURCE: Advisory Commission on Intergovernmental Relations

STATEMENT

OF THE

NATIONAL DECORATING PRODUCTS ASSOCIATION

IN SUPPORT OF

S. 639 and S. 1099

The National Decorating Products Association, a nationwide association of paint and wallpaper retailers representing 7,000 stores in every state, strongly supports federal legislation that would eliminate the "tax-immune" status of sales by out-of-state direct marketers. The growth of these direct marketers threatens the existence not only of the traditional decorating products store, but also Main Street retailers in nearly every industry.

S. 639, introduced by Senator Burdick (D-N.D.), and S. 1099 (The Equity in Interstate Competition Act of 1987), introduced by Senator Cochran (R-Miss.), attempt to reverse National Bellas Hess v. Illinois Department of Revenue, the 20-year old Supreme Court ruling forbidding states to require out-of-state direct marketers to collect and remit sales or use tax on purchases by their residents.

The 1967 Supreme Court ruling in the National Bellas Hess case has led to the creation of businesses that thrive on the sales tax exemption that it created. In 1985, the Direct Marketing Association estimated that the direct marketing industry controlled 15% of retail sales. They expect that figure to reach 20% by 1990. However, with the expanding use of "800" numbers, cable television, and the personal computer as a link to direct sales, that figure may well be even higher.

The fact that Main Street paint and wallpaper retailers provide trained sales personnel, show rooms, dealer preparation, and after-sale service to consumers enables out-of-state direct marketers to prey on retailers. These marketers urge customers to shop in their neighborhood stores, write down the color and model number of an item, and then order the same merchandise from an out-of-state marketer who offers discount prices because, unlike the retailer, he is not required to collect and remit the sales tax. Even if the difference in the price is only equal to the sales tax rate of the state that the product is shipped to, the savings can be quite significant on "big ticket" items, such as paint and wallpaper.

S. 639 and S. 1099 can help the Main Street paint and wallpaper retailers to compete on a level playing field with the out-ofstate direct marketers. We estimate that paint and wallpaper retailers are losing more than $1 billion in sales annually as a result of this unfair price advantage enjoyed by the direct marketers. Through no fault of his own, the Main Street paint and wallpaper retailer is quickly losing his ability to compete in the marketplace because he must collect the state sales tax while his direct marketer competitors do not.

The sales tax loop-hole created by the National Bellas Hess decision not only generates unfair competition, it also threatens state revenues. Some state officials are warning that by the year 2000, sales tax revenues could decline by as much as 25% unless mail and telephone order firms are forced to collect sales and use taxes. If this inequity is not resolved, cash-strapped

states and cities will be required to raise their sales tax rates, which will drive even more consumers away from the community retailers to the tax-free direct marketers. This vicious cycle can only be broken when out-of-state direct marketers and Main Street businesses are competing on a level playing field.

Though we support this legislation because it would make the playing field more level for the Main Street retailer, we oppose the annual gross sales minimum thresholds of $500,000 per state or $12.5 million nationally that are contained in S. 1099. Nearly all NDPA members are small paint and wallpaper stores whose gross sales are less than $12.5 million. Nevertheless, they must collect and remit sales tax; direct marketers should be required to do no less. Accordingly, NDPA believes that all direct marketers should be required to collect and remit sales and use taxes, regardless of their size.

In addition, if the Subcommittee decides to recommend approval of S. 639, that bill should be strengthened by expressly authorizing states to require out-of-state sellers to collect and remit the applicable state use tax. National Bellas Hess prohibits a state from requiring out-of-state direct marketers to collect and remit the use tax imposed by the state on its residents' use of property purchased in other states. It does not prohibit a state from imposing that use tax. The problem created by National Bellas Hess is that, without jurisdiction over an out-of-state direct seller, no state has an efficient means of determining which consumers are liable for the use tax, much less collecting that tax. The bills before the Subcommittee should rectify both problems by authorizing each state to require all out-of-state direct marketers to collect the state's use tax on purchases by its residents, and to remit the collected tax to the state in which the purchaser resides.

The National Decorating Products Association would like to thank the members of the Subcommittee on Taxation and Debt Management for addressing the issue of the unfair advantage that the outof-state seller enjoys over the Main Street retailer. We will be pleased to respond to any requests by the Subcommittee for additional information.

STATEMENT

OF THE

NATIONAL HOME FURNISHINGS ASSOCIATION

IN SUPPORT OF

S. 639 and S. 1099

The National Home Furnishings Association, which is a nationwide association of furniture retailers with 3,500 members representing 13,000 stores in every state, strongly supports federal legislation that would eliminate the "tax-immune" status of sales by out-of-state direct marketers. The growth of these direct marketers threatens the existence not only of the traditional home furnishings store, but also Main Street retailers in nearly every industry.

S. 639, introduced by Senator Burdick (D-N.D.), and S. 1099 (The Equity in Interstate Competition Act of 1987), introduced by Senator Cochran (R-Miss.) attempt to reverse National Bellas Hess v. Illinois Department of Revenue, the 20-year old Supreme Court ruling forbidding states to require out-of-state direct marketers to collect and remit sales or use tax on purchases by their residents.

The 1967 Supreme Court ruling in the National Bellas Hess case has led to the creation of businesses that thrive on the sales tax exemption that it created. In 1985, the Direct Marketing Association estimated that the direct marketing industry controlled 15% of retail sales. They expect that figure to reach 20% by 1990. However, with the expanding use of "800" numbers, cable television, and the personal computer as a link to direct sales, that figure may well be even higher.

The fact that Main Street furniture retailers provide trained sales personnel, show rooms, dealer preparation, and after-sale service to consumers enables out-of-state direct marketers to prey on retailers. These marketers urge customers to shop in their neighborhood stores, write down the color and model number of an item, and then order the same merchandise from an out-of-state marketer who offers discount prices because, unlike the retailer, he is not required to collect and remit the sales tax. Even if the difference in the price is only equal to the sales tax rate of the state that the product is shipped to, the savings can be quite significant on "big ticket" items, such as furniture.

S. 639 and S. 1099 can help the Main Street furniture retailers to compete on a level playing field with the out-of-state direct marketers. Assuming that approximately 10% of all furniture sales are made by out-of-state direct marketings, we estimate that furniture retailers are losing more than $2.5 billion in sales annually as a result of this unfair price advantage enjoyed by the direct marketers. Through no fault of his own, the Main Street furniture retailer is quickly losing his ability to compete in the marketplace because he must collect the state sales tax while his direct marketer competitors do not.

The sales tax loop-hole created by the National Bellas Hess decision not only generates unfair competition, it also threatens state revenues. If out-of-state direct marketers are selling $2.5 billion of furniture annually, and the average sales tax

rate is 5%, then $125 million in sales tax revenues are not being collected and paid to the appropriate state treasuries. Some state officials are warning that by the year 2000, sales tax revenues could decline by as much as 25% unless mail and telephone order firms are forced to collect sales taxes. If this inequity is not resolved, cash-strapped states and cities will be required to raise their sales tax rates, which will drive even more consumers away from the community retailers to the tax-free direct marketers. This vicious cycle can only be broken when out-of-state direct marketers and Main Street businesses are competing on a level playing field.

Though we support this legislation because it would make the playing field more level for the Main Street retailer, we oppose the annual gross sales minimum thresholds of $500,000 per state, or $12.5 million nationally that are contained in S. 1099. Nearly all NHFA members are small furniture stores whose gross sales are less than $12.5 million. Nevertheless, they must collect and remit sales tax; direct marketers should be required to do no less. Accordingly, NHFA believes that all direct marketers should be required to collect and remit sales and use taxes, regardless of their size.

In addition, if the Subcommittee decides to recommend approval of S. 639, that bill should be strengthened by expressly authorizing states to require out-of-state sellers to collect and remit the applicable state use tax. National Bellas Hess prohibits a state from requiring out-of-state direct marketers to collect and remit the use tax imposed by the state on its residents' use of property purchased in other states. It does not prohibit a state from imposing that use tax. The problem created by National Bellas Hess is that, without jurisdiction over an out-of-state direct seller, no state has an efficient means of determining which consumers are liable for the use tax, much less collecting that tax. The bills before the Subcommittee should rectify both problems by authorizing each state to require all out-of-state direct marketers to collect the state's use tax on purchases by its residents, and to remit the collected tax to the state in which the purchaser resides.

The National Home Furnishings Association would like to thank the members of the Subcommittee on Taxation and Debt Management for addressing the issue of the unfair advantage that the out-of-state seller enjoys over the Main Street retailer. We will be pleased to respond to any requests by the Subcommittee for additional information.

STATE OF NEBRASKA

KAY A. ORR, GOVERNOR

November 2, 1987

Senator Max Baucus
Chairman
Subcommittee on Taxation and
Debt Management
Senate Finance Committee
Washington, D.C. 20510

Dear Senator Baucus:

RE: Written Testimony in Support of S. 1099

I concur with and strongly endorse the testimony of Nebraska State Senator Elroy Hefner and offer the following comments in support of S. 1099.

Under current federal law, it is impossible for Nebraska to collect sales and use taxes due from items marketed in Nebraska and sold to Nebraskans through the mail by out-of-state merchants. We have tried to minimize this loss of sales tax revenue by passing legislation which (1) broadened the meaning of doing business in this state to include regular solicitation of sales in Nebraska through Nebraska advertising media, and (2) facilitated increased cooperation with neighboring states in the identification of products being delivered into Nebraska without tax being charged. However, from a practical standpoint, both of these efforts are quite costly, of limited effectiveness, subject to court challenge, and offer at best only a piecemeal solution.

S. 1099 does not represent a new tax. Consumers have always been obligated to pay the sales or use tax on such purchases. However, because of the large number of individual consumers and the relatively small dollar amount of most purchases, a state cannot practicably accomplish effective collection of the tax without requiring out-of-state mail order vendors to collect and remit the sales tax to the respective states to which it is due.

As we all are aware, the mail order sales business is growing tremendously. As more and more consumers avail themselves of this method of shopping, sales tax revenues will no doubt diminish proportionately as the burden and cost to state tax officials grow more onerous.

For the sake of uniformity, simplicity, and fairness to vendors, consumers, and states, I urge your support for S. 1099.

Sincerely,

Kay A. Orr

KAY A. ORR
Governor

KAO:DA:k:84

Nebraska State Legislature

Dear Senator Baucus:

It is fast becoming a common practice throughout the nation to use catalogs, TV advertisements, "800" telephone order numbers, credit cards, and direct-mail advertising for the purchase of goods from an "out-of-state" retailer to be delivered to the buyer's residence. Continuing technological changes in communications indicate the mail order business will continue to boom. Ordering goods by computer is quickly becoming a reality. These sales are taxable under Nebraska law---despite a misconception by some Nebraska residents that they are not. It is simply a tax the state has been unable to collect. Sales made through the use of these methods occupy an essentially "tax-free" zone.

In the past three years I have sponsored legislation in the Nebraska Legislature to collect sales and use tax on taxable items sold through the mail to Nebraska residents by out-of-state merchants. I have sponsored this legislation because I believe it is unfair to in-state merchants who collect and remit this tax. In-state merchants operate at a disadvantage if they must collect a tax on the merchandise they sell, when their competing interests out of state do not. This puts states in the awkward position of placing a disadvantage on residents of their own state, and giving a break to out-of-state interests. The present restrictions on states which prohibit them from collecting sales and use taxes from out-of-state merchants present them from realizing a fair, competitive business arena. Unfortunately, from a practical perspective, it is impossible for a state to collect the tax on items marketed and purchased through the mail under present federal law. Many states rely heavily on sales and use taxes for revenue, Nebraska included. It it therefore necessary that Congress pass legislation which will assist states in the collection of sales and use taxes on items purchased through the mail. S. 1099 will help solve this problem.

The Nebraska Legislature passed LB 304 on February 25, 1987. The Governor signed the bill on March 2, 1987, and it became operative on October 1, 1987, the beginning of a tax quarter. LB 304 amended the definition of "engaged in business in this state" to include any regular solicitation of sales in Nebraska through Nebraska advertising media. Any entity falling under the definition of "engaged in business in this state" is required to collect sales and use taxes with its sales, and submit these taxes to the state. LB 304 seeks to establish a nexus between out-of-state vendors and the state, thereby giving the state the legal and practical authority to collect sales and use taxes by requiring these vendors to remit the tax to the state.

The Attorney General of the State of Nebraska issued an opinion on LB 304 indicating parts of the bill may be unconstitutional. The final determination could be made by the Courts. Or the final determination could be made in a much simpler fashion---the passage of legislation like S. 1099. Such legislation would clear the way for Nebraska and other states to collect taxes which are due to the states. It would also avoid court tests which may have results neither the states nor Congress would like.

In the meantime states will continue to pass legislation in a piecemeal fashion. This is an inconvenience to vendors who are affected by states which may have varying quirks in their laws. States will continue to pass legislation such as LB 304 because of their revenue needs, but just as importantly, because they believe it is unfair to their in-state vendors not to do so. It has been estimated by the Advisory Committee on Intergovernmental Relations that Nebraska loses up to $13 million annually due to the limited authority the state has to collect these taxes. Again, the simplest solution is for Congress to pass legislation to allow states to collect the taxes to which they are entitled.

I have included a copy of LB 304 and LR 123, a legislative resolution passed by the Nebraska Legislature in support of HR 1242 when the Legislature was in session. The information contained in LR 123 about HR 1242 is relevant to S. 1099.

Sincerely,

Elroy M. Hefner

Elroy M. Hefner
State Senator, 19th District

LEGISLATIVE RESOLUTION 123

Introduced by Hefner, 19; V. Johnson, 8

WHEREAS, the commerce clause of the Constitution of the United States reserves to Congress the power to regulate and control interstate commerce; and

WHEREAS, the subcommittee on Select Revenue Measures, Committee on Ways and Means, United States House of Representatives, will hold a public hearing on HR 1242, the Interstate Sales Tax Collection Act of 1987, on May 13, 1987; and

WHEREAS, HR 1242 would authorize states to require retailers to collect sales and use taxes on interstate sales and require such retailers to file information returns with the Internal Revenue Service for the purpose of assisting states in the collection of such taxes; and

WHEREAS, the Legislature passed LB 304 on February 25, 1987, and the Governor signed the bill on March 2, 1987; and

WHEREAS, the purpose of LB 304 is to broaden the state's authority in collecting sales and use taxes on mail order sales; and

WHEREAS, it is unfair to businesses operating within the state to collect and remit sales and use taxes while out-of-state competition doing business through the mail does not collect or remit such taxes; and

WHEREAS, HR 1242 would greatly assist the State of Nebraska in pursuing the goals of LB 304; and

WHEREAS, the Advisory Committee on Intergovernmental Relations has estimated that under the present scheme Nebraska may be losing up to an estimated 13 million dollars annually.

NOW, THEREFORE, BE IT RESOLVED BY THE MEMBERS OF THE NINETIETH LEGISLATURE OF NEBRASKA, FIRST SESSION:

1. That the Legislature encourages the United States House Ways and Means Committee and its Subcommittee on Select Revenue Measures to support HR 1242.

2. That the Legislature encourages Congress to swiftly adopt the provisions of HR 1242.

3. That a copy of this resolution be presented to United States Representative Charles B. Rangel, Chairperson of the Subcommittee on Select Revenue Measures at the public hearing on HR 1242.

4. That copies of this resolution be sent to Representative Dan Rostenkowski, Chairperson of the House Ways and Means Committee, Representatives Byron L. Dorgan, Hal Daub, and Sander Levin, sponsors of HR 1242, and Representatives Virginia Smith and Doug Bereuter.

Wm. E. Barrett

PRESIDENT OF THE LEGISLATURE

I, Patrick J. O'Donnell, hereby certify that the foregoing is a true and correct copy of Legislative Resolution 123, which was passed by the Legislature of Nebraska in Ninetieth Legislature, First Session, on the eighth day of May, 1987.

Patrick J. O'Donnell

CLERK OF THE LEGISLATURE

LEGISLATIVE BILL 304

Approved by the Governor March 2, 1987

Introduced by Hefner, 19

AN ACT relating to sales and use tax; to amend section 77-2702, Reissue Revised Statutes of Nebraska, 1943; to redefine terms; to provide an operative date; and to repeal the original section.

Be it enacted by the people of the State of Nebraska,

Section 1. That section 77-2702, Reissue Revised Statutes of Nebraska, 1943, be amended to read as follows:

77-2702. For the purpose of sections 77-2702 to 77-2713, unless the context otherwise requires:

(1) Business shall mean any activity engaged in by any person or caused to be engaged in by him or her with the object of gain, benefit, or advantage, either direct or indirect;

(2) Tax Commissioner shall mean the Tax Commissioner of the State of Nebraska;

(3) Contractor or repairperson shall mean any person who performs any repair services or any improvement upon real estate, including leased property, and who, as a necessary and incidental part of performing such services, incorporates tangible personal property belonging to him or her into the property being so repaired or improved. Contractor or repairperson shall be considered to be the consumer of such tangible personal property furnished by him or her and incorporated into the property being so repaired or improved for all the purposes of the Nebraska Revenue Act of 1967;

(4)(a) Gross receipts shall mean the total amount of the sale or lease or rental price, as the case may be, of the retail sales of the retailers, valued in money, whether received in money or otherwise, without any deduction on account of any of the following:

(i) The cost of tangible personal property sold. In accordance with such rules and regulations as the Tax Commissioner may prescribe, a deduction may be taken if the retailer has purchased tangible personal property for some purpose other than resale, has reimbursed his or her vendor for tax which the vendor is required to pay to the state or has paid the use tax

with respect to the tangible personal property, and has resold the property prior to making any use of the tangible personal property other than retention, demonstration, or display while holding it for sale in the regular course of business. If such a deduction is taken by the retailer, no refund or credit will be allowed to his or her vendor with respect to the sale of the tangible personal property;

(ii) The cost of the materials used, labor or service costs, interest paid, losses, or any other expense;

(iii) The cost of transportation of the tangible personal property prior to its sale to the purchaser;

(iv) The amount of any excise or property tax levied against the tangible personal property, except as otherwise provided in the Nebraska Revenue Act of 1967; or

(v) The amount charged for warranties, guarantees, or maintenance agreements;

(b) Gross receipts of every person engaged as a public utility or as a community antenna television service operator or any person involved in the connecting and installing of services defined in subdivision (4)(b) of this section shall mean:

(i) In the furnishing of telephone communication service, the gross income received from furnishing local exchange telephone service and intrastate message toll telephone service;

(ii) In the furnishing of telegraph service, the gross income received from the furnishing of intrastate telegraph services;

(iii) In the furnishing of gas, electricity, sewer, and water service except water used for irrigation of agricultural lands, manufacturing purposes, and the care of animal life, the products of which ordinarily constitute food for human consumption, the gross income received from the furnishing of such services upon billings or statements rendered to consumers for such utility services; and

(iv) In the furnishing of community antenna television service, the gross income received from the furnishing of such community antenna television service as regulated under sections 18-2201 to 18-2205.

Gross receipts shall also mean gross income received from the provision, installation, construction, servicing, or removal of tangible personal property used in conjunction with the furnishing, installing, or connecting of any such public utility services or

community antenna television service. Gross receipts shall not mean gross income received from telephone directory advertising;

(c) Gross receipts of every person engaged in selling, leasing, or otherwise providing intellectual or entertainment property shall mean:

(i) In the furnishing of computer software, the gross income received, including the charges for coding, punching, or otherwise producing computer software and the charges for the tapes, disks, punched cards, or other properties furnished by the seller. Gross receipts shall not include the amount charged for training customers in the use of computer software, if such amount is separately stated and such separate statement is not used as a means of avoiding imposition of the tax upon the actual sales price of the computer software; and

(ii) In the furnishing of videotapes and movie film, the gross income received from the license, franchise, or other method establishing the charge, except the gross income received from videotape and film rentals when the admission tax is charged under the Nebraska Revenue Act of 1967; and

(d) Gross receipts does not include any of the following:

(i) Cash discounts allowed and taken on sales;

(ii) Sales price of tangible personal property returned by customers when the full sales price is refunded either in cash or credit;

(iii) Except as provided in subdivision (4)(b) of this section, the amount charged for labor or services rendered in installing or applying the tangible personal property sold if such amount is separately stated and such separate statement is not used as a means of avoiding imposition of the tax upon the actual sales price of the tangible personal property;

(iv) The amount charged for finance charges, carrying charges, service charges, or interest from credit extended on sales of tangible personal property under contracts providing for deferred payments of the purchase price if such charges are not used as a means of avoiding imposition of the tax upon the actual sales price of the tangible personal property;

(v) The value of tangible personal property taken by a seller in trade as all or a part of the consideration for a sale of tangible personal property of any kind or nature;

(vi) The value of a motor vehicle taken by any person in trade as all or a part of the consideration

for a sale of another motor vehicle;

(vii) For purposes of the sales or use tax, if the retailer establishes to the satisfaction of the Tax Commissioner, and has been given prior approval by the Tax Commissioner, that the sales or use tax has been added to the total amount of the sale price and has not been absorbed by him or her, the total amount of the sale price shall be deemed to be the amount received exclusive of the tax imposed; or

(viii) Receipts from conditional sale contracts, installment sale contracts, rentals, and leases executed in writing prior to June 1, 1967, and with delivery of the tangible personal property prior to June 1, 1967, are not subject to the tax imposed by the Nebraska Revenue Act of 1967 if such conditional sale contracts, installment sale contracts, rentals, or leases are for a fixed price and are not subject to negotiation or alteration;

(5) In this state or within the state shall mean within the exterior limits of the State of Nebraska, and includes all the territory within these limits owned by or ceded to the United States of America;

(6) Occasional sale shall mean:

(a) A sale of tangible personal property which is the subject of any intercompany sale involving any parent, subsidiary, or brother-sister company relationship under subsection (5) of section 77-2704 and which was either originally acquired prior to June 1, 1967, or, if acquired thereafter, the seller directly or indirectly has previously paid a sales or use tax thereon, including:

(i) From one corporation to another corporation pursuant to a reorganization. As used in this subdivision, reorganization shall mean a statutory merger or consolidation or the acquisition by a corporation of substantially all of the properties of another corporation when the consideration is solely all or a part of the voting stock of the acquiring corporation or of its parent or subsidiary corporation;

(ii) In connection with the winding up, dissolution, or liquidation of a corporation only when there is a distribution of the property of such corporation to the shareholders in kind if the portion of the property so distributed to the shareholder is substantially in proportion to the share of stock or securities held by the shareholder;

(iii) To a corporation for the purpose of organization of such corporation when the former owners

of the property transferred are immediately after the transfer in control of the corporation and the stock or securities received by each is substantially in proportion to his or her interest in the property prior to the transfer;

(iv) To a partnership in the organization of such partnership if the former owners of the property transferred are immediately after the transfer members of such partnership and the interest in the partnership, received by each, is substantially in proportion to his or her interest in the property prior to the transfer; or

(v) From a partnership to the members thereof when made in kind in the dissolution of such partnership if the portion of the property so distributed to the members of the partnership is substantially in proportion to the interest in the partnership held by the members;

(b) A sale of tangible personal property consisting of household goods and personal effects if each of the following conditions is met and if any one condition is not met then the entire gross receipts shall be subject to the tax imposed by section 77-2703:

(i) Such sales are by an individual at his or her residence or if more than one individual's property is involved such sales are by one of the individuals involved at the residence of one of the individuals;

(ii) Such sales do not occur at any residence for more than three days during a calendar year;

(iii) Such individual or individuals or any member of any of their households do not conduct or engage in a trade or business in which similar items are sold;

(iv) Such property sold was originally acquired for and used for personal use; and

(v) Such property is not otherwise excepted from the definition of occasional sale;

(c) Any sale of business or farm machinery and equipment if each of the following conditions is met and if any one condition is not met the entire gross receipts shall be subject to the tax imposed by section 77-2703:

(i) Such machinery and equipment was transferred without the aid or supervision of any third party. For the purposes of this section, third party shall include anyone other than the owner and the buyer. The release of a lien held by a third party shall not constitute aid;

(ii) Such machinery or equipment was used by

the seller as a depreciable capital asset in connection with the farm or business for a period of at least one year;

(iii) Such property was originally acquired prior to June 1, 1967, or if acquired thereafter, the seller directly or indirectly has previously paid a sales or use tax thereon; and

(iv) Such property is not otherwise excepted from the definition of occasional sale;

(d) A sale of tangible personal property by an organization created exclusively for religious purposes or an agent of the organization for such sale if each of the following conditions is met and if any one condition is not met then the entire gross receipts shall be subject to the tax imposed by section 77-2703:

(i) All sales occur during an activity conducted by such organization or, if more than one organization is involved, by one of the organizations owning property being sold;

(ii) The organization only sells property it owns during one such activity in a calendar year; and

(iii) The activity does not last longer than three consecutive days; and

(e) Occasional sale shall not include any sale of tangible personal property directly by or any sale which is supervised or aided by an auctioneer or an agent or employee of an auctioneer;

(7) Person shall mean and include any individual, firm, copartnership, joint venture, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, trustee, syndicate, cooperative, assignee, or any other group or combination acting as a unit, but shall also include the United States or any agency thereof, this state or any agency hereof, or any city, county, district, or other political subdivision of this state, or agency thereof;

(8) Purchase shall mean any transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration, including, but not limited to, a transfer of the possession of tangible personal property in which the seller retains the title as security for the payment of the price and a transfer, for a consideration, of tangible personal property which has been produced, fabricated, or printed to the special order of the customer;

(9) Rental price or lease price shall mean the

total amount for which tangible personal property is rented or leased, with rent or lease payments set at a fair market value, valued in money, whether paid in money or otherwise, without any deduction on account of (a) the cost of the tangible personal property rented or leased, (b) the cost of material used, labor or service cost, interest charged, losses, or any other expenses, or (c) the cost of transportation of tangible personal property at any time. The total amount for which tangible personal property is rented or leased includes any services which are a part of the lease or rental and any amount for which credit is given to the lessee by the lessor or renter;

(10) Retail sale or sale at retail shall mean:

(a) A sale for any purpose other than for resale in the regular course of business of tangible personal property;

(b) A sale of tangible personal property to an advertising agency which purchases the tangible personal property as an agent for a disclosed or undisclosed principal. The advertising agency is and remains liable for the sales and use tax on the purchase the same as if the principal had made the purchase directly;

(c) The delivery in this state of tangible personal property by an owner or former owner thereof or by a factor or agent of such owner, former owner, or factor, if the delivery is to a customer or person for redelivery to a consumer, pursuant to a retail sale made by a retailer not engaged in business in this state. The person making the delivery in such cases shall include the delivery person's selling price of the tangible personal property in his or her gross receipts; and

(d) The sale of admissions which shall mean the right or privilege to have access to or use a place or location. When an admission to an activity is combined with the solicitation of a contribution, the portion or the amount charged representing the fair market price of the admission shall be considered a retail sale subject to the tax imposed by section 77-2703. The organization conducting the activity shall determine the amount properly attributable to the purchase of the privilege, benefit, or other consideration in advance and such amount shall be clearly indicated on any ticket, receipt, or other evidence issued in connection with the payment. Admissions shall not include fees charged by (i) elementary or secondary schools, public or private, or (ii) school districts, student organizations, or

parent-teacher associations pursuant to an agreement with the proper school authorities, in an elementary or secondary school, public or private, during the regular school day or at an approved function of any such school;

(ll) Retail sale or sale at retail shall not include the sale of:

(a) Tangible personal property which will enter into and become an ingredient or component part of tangible personal property manufactured, processed, or fabricated for ultimate sale at retail;

(b)(i) Any form of animal life of a kind the products of which ordinarily constitute food for human consumption. Animal life shall be defined in part, but not limited to, live poultry or livestock on the hoof when sales are made by the grower, producer, feeder, or by any person engaged in the business of bartering, buying, or selling live poultry or livestock on the hoof;

(ii) Feed for any form of animal life or water which is supplied for consumption by animal life or which is otherwise used in caring for animal life of a kind the products of which ordinarily constitute food for human consumption or of a kind the pelts of which ordinarily are used for human apparel; feed shall mean and include, but is not limited to, all grains, minerals, salts, proteins, fats, fibers, vitamins, grit, and antibiotics commonly used as feed or feed supplements;

(iii) Seeds and annual plants, the products of which ordinarily constitute food for human consumption and which seeds and annual plants are sold to commercial producers of such products, and seed legumes, seed grasses, and seed grains when sold to be used exclusively for agricultural purposes; or

(iv) Agricultural chemicals to be applied to land or crops the products of which are to be used as food for human consumption or sold in the regular course of business;

(c) Nonreturnable containers when sold without the contents to persons who place the contents in the container and sell the contents together with the container; containers when sold with the contents if the sales price of the contents is not required to be included in the measure of the taxes imposed by the Nebraska Revenue Act of 1967; and returnable containers when sold with the contents in connection with a retail sale of the contents or when resold for refilling. The term returnable containers means containers of a kind

customarily returned by the buyer of the contents for reuse. All other containers are nonreturnable containers;

(d) Tangible personal property the transfer of which to the consumer constitutes an occasional sale or the transfer of which to the consumer is made by way of an occasional sale;

(e) Tangible personal property the sale, purchase, or use of which has been taxed to that taxpayer in another state, territory, or possession of the United States of America when such other state, territory, or possession grants a reciprocal exclusion or an exemption to similar transactions in this state;

(f) The purchase in this state or the purchase without this state, with title passing in this state, of materials and replacement parts, when used as or when used directly in the repair and maintenance or manufacture of railroad rolling stock, whether owned by a railroad or by any person, whether a common or contract carrier or otherwise, motor vehicles, watercraft, or aircraft engaged as common or contract carriers of persons or property or the purchase in such manner of motor vehicles, watercraft, or aircraft to be used as common or contract carriers of persons or property. All purchasers seeking to take advantage of the exemption shall apply to the Tax Commissioner for a common or contract carrier exemption. All common or contract carrier exemption certificates shall expire on October 31, 1986, and on October 31 every three years thereafter. All persons seeking to continue to take advantage of the common or contract carrier exemption shall apply for a new certificate at the expiration of the prior certificate. The Tax Commissioner shall notify such exemption certificate holders at least sixty days prior to the expiration date of such certificate that their certificate will expire and be null and void as of ~~October 31, 1986~~ such date; or

(g) Railroad rolling stock whether purchased by a railroad or by any other person;

(12) Retailer shall mean:

(a)(i) Every seller engaged in the business of making sales of tangible personal property for storage, use, or other consumption or in the business of making sales at auction of tangible personal property owned by the person or others for storage, use, or other consumption. Retailer shall include, in the case of sales at auction of tangible personal property when the person collecting the proceeds of the auction is not the auctioneer or an agent or employee of the auctioneer,

the person collecting the proceeds of the auction, other than the owner of the tangible personal property, together with his or her principal, if any, and retailer shall not include the auctioneer in such case;

(ii) Every person who leases or rents to another tangible personal property for storage, use, or other consumption, except film rentals when an admission tax is charged under the Nebraska Revenue Act of 1967 and railroad rolling stock interchanged pursuant to the provisions of the Interstate Commerce Act;

(iii) Every person engaged in the business of renting or furnishing for periods of less than thirty days any room or rooms, lodgings, or accommodations in any hotel, motel, inn, tourist camp, tourist cabin, or any other place, except a facility licensed under the provisions of Chapter 71, article 20, in which rooms, lodgings, or accommodations are regularly furnished for a consideration or a facility operated by an educational institution established under Chapter 79 or 85 in which rooms are regularly used to house students for a consideration for periods in excess of thirty days, shall be and constitute a retail merchant in respect thereto and the gross income received therefrom shall constitute gross income of a retail merchant received from transactions constituting selling at retail;

(iv) Every person engaged as a public utility in furnishing telephone, telegraph, gas, electricity, sewer, and water service, and every person engaged in furnishing community antenna television service as defined in subdivision (4)(b) of this section; and

(v) Every person renting or otherwise furnishing tangible personal property under an agreement requiring the periodic cleaning or laundering of such tangible personal property; and

(b) When the Tax Commissioner determines that it is necessary for the efficient administration of the Nebraska Revenue Act of 1967 to regard any salespersons, representatives, peddlers, canvassers, or auctioneers and persons conducting auction sales as the agents of the dealers, distributors, supervisors, or employers under whom they operate or from whom they obtain the tangible personal property sold by them irrespective of whether they are making sales on their own behalf or on behalf of such dealers, distributors, supervisors, auctioneers, or employers, the Tax Commissioner may, at his or her discretion, treat such agent as the vendor jointly responsible with his or her principal, distributor, supervisor, or employer for the purposes of the Nebraska Revenue Act of 1967;

(13) Sale shall mean and include any transfer of title or possession or segregation in contemplation of transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration. Sale shall include:

(a) The producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish, either directly or indirectly, the materials used in the producing, fabricating, processing, printing, or imprinting;

(b) The furnishing and distributing of tangible personal property for a consideration by social clubs and fraternal organizations to their members or others;

(c) The furnishing, preparing, or serving for a consideration of food, meals, or drinks;

(d) A transaction whereby the possession of property is transferred but the seller retains the title as security for the payment of the price;

(e) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer; and

(f) The renting or furnishing for periods of less than thirty days of any room or rooms, lodgings, or accommodations in any hotel, motel, inn, tourist camp, tourist cabin, or any other place, except a facility licensed under the provisions of Chapter 71, article 20, in which rooms, lodgings, or accommodations are regularly furnished for a consideration or a facility operated by an educational institution established under Chapter 79 or 85 in which rooms are regularly used to house students for a consideration for periods in excess of thirty days;

(14) Sale for resale shall mean a sale of tangible personal property to any purchaser who is purchasing such tangible personal property for the purpose of reselling it in the normal course of his or her business, either in the form or condition in which it is purchased or as an attachment to or integral part of other tangible personal property. A sale for resale shall include a sale of tangible personal property to a purchaser for the sole purpose of that purchaser's renting or leasing such tangible personal property to another person, with rent or lease payments set at a fair market value, or film rentals for use in a place where an admission is charged that is subject to

taxation under the Nebraska Revenue Act of 1967, but not if incidental to the renting or leasing of real estate;

(15)(a) Sales price shall mean the total amount for which tangible personal property is sold, valued in money, whether paid in money or otherwise, without any deduction on account of:

(i) The cost of the tangible personal property sold;

(ii) The cost of material used, labor or service cost, interest paid, losses, or any other expenses;

(iii) The cost of transportation of the tangible personal property. The total amount for which tangible personal property is sold includes any services which are a part of the sale and any amount for which credit is given to the purchaser by the seller;

(iv) The cost of computer software contained on the tangible personal property; or

(v) The cost of any license, franchise, or lease for the use of computer software or entertainment properties such as videotapes or movie films; and

(b) Sales price does not include any of the following:

(i) Cash discounts allowed and taken on sales;

(ii) The amount charged for tangible personal property returned by customers when the entire amount charged therefor is refunded either in cash or credit;

(iii) The amount charged for labor or services rendered in installing and applying the property sold if such amount is separately stated and such separate statement is not used as a means of avoiding imposition of the tax upon the actual sales price of the tangible personal property;

(iv) The amount charged for finance charges, carrying charges, service charges, or interest from credit extended on sales of tangible personal property under contracts providing for deferred payments of the purchase price if such charges are not used as a means of avoiding imposition of the tax upon the actual sales price of the tangible personal property;

(v) The value of tangible personal property taken by a seller in trade as all or a part of the consideration for a sale of tangible personal property of any kind or nature; or

(vi) The value of a motor vehicle taken by any person in trade as all or part of the consideration for a sale of another motor vehicle;

(16) Seller shall include every person engaged in the business of selling, leasing, or renting tangible

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personal property of a kind the gross receipts from the retail sale, lease, or rental of which are required to be included in the measure of the sales tax;

(17) Storage shall include any retention in this state for any purposes except sale in the regular course of business or subsequent use solely outside this state of tangible personal property purchased from a retailer, other than tangible personal property which will enter into or become an ingredient or component part of tangible personal property manufactured, processed, or fabricated for ultimate sale at retail. Except for a transaction that is subject to sales tax under the Nebraska Revenue Act of 1967, neither storage nor use as defined in this subdivision shall include the keeping, retaining, or exercising of any right or power over tangible personal property for the purpose of subsequently transporting it outside the state or for the purpose of being processed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property to be transported outside the state and thereafter used solely outside the state;

(18) Tangible personal property shall mean personal property which may be seen, weighed, measured, felt, or touched or which is in any other manner perceptible to the senses and includes tangible personal property which is used to convey computer software;

(19) Taxpayer shall mean any person subject to a tax imposed by sections 77-2702 to 77-2713;

(20) Use shall mean the exercise of any right or power over tangible personal property incident to the ownership or possession of that tangible personal property, except that it does not include the sale of that tangible personal property in the regular course of business or the exercise of any right or power over tangible personal property which will enter into or become an ingredient or component part of tangible personal property manufactured, processed, or fabricated for ultimate sale at retail. Use specifically includes the incorporation of tangible personal property into real estate or into improvements upon real estate without regard to the fact that such real estate and improvements may subsequently be sold as such; and

(21) Engaged in business in this state shall mean and include any of the following:

(a) Maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary or agent, by whatever name called, an office, place of distribution, sales or sample room

or place, warehouse, storage place, or other place of business in this state;

(b) Having any representative, agent, salesperson, canvasser, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, or taking orders for any tangible personal property; ~~or~~

(c) Deriving rentals from a lease of tangible personal property in this state by any retailer;

(d) Soliciting retail sales of tangible personal property from residents of this state on a continuous, regular, or systematic basis by means of advertising which is broadcast from or relayed from a transmitter within this state or distributed from a location within this state;

(e) Soliciting orders from residents of this state for tangible personal property by mail, if the solicitations are continuous, regular, seasonal, or systematic and if the retailer benefits from any banking, financing, debt collection, or marketing activities occurring in this state or benefits from the location in this state of authorized installation, servicing, or repair facilities;

(f) Being owned or controlled by the same interests which own or control any retailer engaged in business in the same or similar line of business in this state; or

(g) Maintaining or having a franchisee or licensee operating under the retailer's trade name in this state if the franchisee or licensee is required to collect the tax under the Nebraska Revenue Act of 1967.

Sec. 2. This act shall become operative on October 1, 1987.

Sec. 3. That original section 77-2702, Reissue Revised Statutes of Nebraska, 1943, is repealed.

December 4, 1987

STATEMENT OF ABRAHAM BIDERMAN
COMMISSIONER, NEW YORK CITY DEPARTMENT OF FINANCE
TO
THE SUBCOMMITTEE ON TAXATION AND DEBT OF FINANCE
THE COMMITTEE ON FINANCE
U.S. SENATE
CONCERNING
THE COLLECTION OF STATE AND LOCAL SALES TAXES
ON INTERSTATE SALES

Thank you for this opportunity to comment to comment on the proposed legislation, S.639 and S.1099, which would authorize the taxation of mail-order sales currently prohibited by the Supreme Court's National Bellas Hess decision.

The City of New York supports legislation by Congress, under its interstate commerce authority, to end the prohibition under Bellas Hess. This prohibition is causing local retailers, whose sales are taxable, to be at a serious competitive disadvantage with respect to direct mail retailers whose sales are not. The Bellas Hess decision has also meant that states and localities lose an estimated $2 billior per year nationally in uncollectible sales taxes on mail order sales. We estimate that New York City is annua ly losing at least $45 million from this drain on our tax base. As the direct mail industry continues its rapid expansion (estimated conservatively at 8-12 percent per year), the competitive position of local retailers and the drain on state and local tax bases will worsen.

Congressional legislation is urgently needed to authorize taxation of mail order sales and such legislation must adequately provide for the collection of local as well as state taxes.

A legislative provision, such as in S.1099, which restricts the collection of local taxes to those imposed at a uniform rate throughout the state, does not adequately address the rights and needs localities. This provision would apply to only 4 or 5 states at most, and even in those states would not fully address the problem. It would not apply to the State of New York, despite the fact that over 45 percent of the sales taxes collected in New York State are local taxes. Since four out of sixty-two New York State counties impose no local sales tax, New York City, with a 4 percent sales tax on local retailers, would be unable to collect any of its sales tax on mail order sales. This result is inequitable and unacceptable. Nationally about twenty percent of sales tax collections are local taxes.

There are at least two ways to provide for collection of local taxes under federal mail order sales tax legislation. One way is to authorize the full application of local as well as state sales taxes to mail order sales as in the language of S.639. Combined with the provisions of S.1099 which set a de minimus threshhold of national sales over $12,500,000, collection of local as well as state taxes would not impose an excessive burden on businesses. Direct mail firms of this size have easy access to cost efficient computer systems which can account for local tax rates; for example, Sears and Penney already use such systems.

In the interest of the compromise necessary to enact legislation, there is a second acceptable way to address the rights and needs to localities. A requirement of for a single uniform mail-order sales tax rate for each state could be retained as long as language is added specifiying that such a rate is special state-local rate for mail order sales, that tax revenues collected are legitimately due to both the state and its localities with sales taxes, and that a state and its localities would share such revenues according to a formula contained in the legislation.

In summary, while we support federal legislation to resolve the problems created by the Bellas Hess decision, any legislation must provide adequately for both localities and states. If mail order sales are properly subject to state taxes, then they are also properly subject to local taxes. There is no logical or legal basis for excluding localities from the legislation under consideration.

Thank you again for the opportunity to comment on the proposed legislation.

STATEMENT SUBMITTED TO THE SENATE FINANCE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
SENATOR MAX BAUCUS, CHAIRMAN
BY
RODERICK G. W. CHU, COMMISSIONER
NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE
ON
COLLECTION OF SALES AND USE TAX BY OUT-OF-STATE VENDORS
(S.1099 AND S.639)

Mr. Chairman and members of the Subcommittee, I want to thank you for the opportunity to submit written testimony subsequent to your November 6, 1987, hearing on this matter of great importance.

Forty-five of our fifty states, plus the District of Columbia, impose the sales and use taxes which would be made more equitable and efficient by enactment of S.1099.

ENDORSEMENT OF NATIONAL ASSOCIATION OF TAX ADMINISTRATORS' TESTIMONY

As Commissioner of Taxation and Finance in the State of New York, I wish to endorse the testimony given by the National Association of Tax Administrators' President John Baldwin. Mr. Baldwin effectively pointed out that:

1. Federal legislation is required to correct the jurisdictional restrictions created by the U.S. Supreme Court's 1967 decision in the National Bellas Hess case;

2. Revenue losses to states exceed $2 billion a year and are rising annually;

3. In-state retail businesses are hurt by the tax disadvantage created by the Bellas Hess decision and the subsequent growth of tax-free interstate mail-order sales;

4. The best efforts of states are not able to effectively reach mail-order sales;

5. There is no constitutional impediment to congressional action in this area; and, finally,

6. S.1099 is a compromise proposal intended to address concerns of the direct marketing industry and provide a compliance system comparable to that imposed on local retailers.

THE PROBLEMS OF FAIRNESS AND EFFICIENCY

The inequities and inefficiencies that currently exist due to the U.S. Supreme Court restrictions in the Bellas Hess case need special emphasis. These restrictions foster tax evasion as well as tax avoidance and leave the states only ineffective, extraordinary and costly choices for enforcement.

Unfair Competition

The business community faces a problem of competitive unfairness in the marketplace because of tax loop-holes created by the jurisdictional standards in the Bellas Hess case. Both large and small retailers who have physical presence in a state are required

to collect sales tax on their local sales and catalog sales in all states in which they do business. Why should other firms have the advantage of being able to compete without having to collect sales tax on deliveries into any state except where their order facility is located?

The marketplace in which both types of stores are operating is the same and the consumers are the same. Our marketplaces are inundated with advertising products in the form of catalogs, television sales programs and newspaper and periodical invitations to use mail-in or toll-free telephone services to place orders. The special non-tax advantages of shopping by mail or telephone, such as avoiding local traffic or weather conditions, makes even more urgent the need to eliminate tax inequities of the present system.

In the State of New York, the "discount" which a firm could offer solely on the basis of not taxing the sale would amount to as much as 8 1/4%. To force any firm to compete under these conditions may well be the difference between a business' success or failure.

The problem is not isolated to interstate direct-mail business. Local retailers in each of our states face a similar inequity in trying to attract customers, from whom they must collect the sales tax, who can avoid tax by making purchases across the state line and having merchandise shipped to them at home. The method and frequency of delivery of these out-of-state purchases can affect a vendor's responsibility to collect tax. Under current interpretations of common law which govern this area of interstate taxation, it is not clear where the responsibility begins, leaving both the states and cross-border vendors in a legal no-man's land.

Why then do we penalize the reputable and law-abiding businesses who operate within our borders and clearly must collect our taxes, while allowing others the opportunity to compete tax-free? The reason for keeping the Bellas Hess decision as the law of our land escapes me, and I think it is time we corrected it.

Tax Evasion

An even more compelling concern is that the Bellas Hess decision is influencing our citizens to violate state laws. Imagine the temptation to the average citizen purchasing a product through a catalog operation that does not collect sales tax, not to report the tax that is owed. The correct thing for the citizen to do in such a situation would be to voluntarily fill out a use tax form and submit it with the tax to the state in which he or she resides. The temptation to evade this tax is alluring, and there is little doubt that substantial amounts of these taxes will not be collected unless the states' powers are restored, allowing us to prove to the public that the tax law can be effectively administered and enforced.

In the past few years, the evidence of tax evasion has become even more disturbing. We now have proof that the Bellas Hess principle is consciously being used to mask multi-million dollar criminal tax evasion schemes. False shipping records have been used by some of America's more prestigious retailers in order to give their clients a sales tax discount. Cartier, Bulgari, Van Cleef and Arpels, Christie Brothers Furs, and Ben Thylan Furs have pleaded guilty and are paying back over $10 million to New York State. Several other jewelers, furriers and furniture stores have also been indicted. While the retailers in question are not primarily mail-order firms, as these investigations and

prosecutions have proven, they use the special privilege granted mail-order sales to camouflage their criminal activity in their home states.

The implication of these developments is that we need better laws to curb the tax avoidance and evasion that has been developing across state borders.

Enforcement Costs

The states have worked hard to deal with the court imposed constraints and uncertainties. But the costs are high. One effort has been to litigate test cases to produce new court standards in light of the changes of the last 20 years. Several states have attempted to take this route. However, it has severe drawbacks.

First of all, it takes lots of time, effort, and money. Second, it is a very uncertain process. Jurisdictional standards for taxation could well be redefined by the courts in a way difficult to live with for both direct marketers and tax administrators. In addition, cases with very limited application may be addressed, leaving us with uncomprehensive answers. Finally, a practical problem has arisen. As each test case has been developed so far, after reaching only a state level of appeal, the defendants have typically dropped their defense, admitted their obligation, and started collecting the tax.

Another solution would be to enter into state-by-state agreements such as New York has done with New Jersey and Pennsylvania. Although these agreements are aimed at countering border sales tax evasion, they could apply to mail-order business between the states as well. Since inauguration of the New York/New Jersey agreement two years ago, nearly 5,000 vendors on both sides of the river have voluntarily signed up to collect the other state's taxes. Unfortunately, most direct-marketing firms have chosen not to participate.

There are other problems using state-by-state agreements to solve the mail-order problem. First, it will take a long time to secure such agreements. Second, there are five states without sales and use taxes. Third, some states would not get proportionate or productive benefits for the energies they would have to expend. For example, I might try to persuade the tax officials in the home state of a vendor to conduct an audit of the company and supply me with the names and addresses of customers in my state. Such an effort would require my sister states to expend substantial resources in obtaining information for my state while not producing any additional revenue for their own states' treasuries. In addition, with millions of vendors in the United States and 17 million New Yorkers, this represents a relatively difficult means of collecting these taxes.

Finally, such a solution could prove especially onerous to the direct-marketing industry whose compliance we seek. They would have two choices. They could voluntarily collect sales taxes including all the various local rates and requirements, or they could refuse and see their soon-to-be-former customers hit with use tax bills for taxes, interest and penalties. Even though the use of "customer list" programs are not the most productive auditing programs we have, interest in this type of enforcement activity through bi-state agreements is spreading beyond our neighboring states because it works, however costly.

CONCLUSION

The arguments for corrective federal legislation are compelling. The proposed federal legislation before us has been the subject of two hearings, and amendments have been offered which address specialized concerns such as local government sharing of receipts, taxpayer assistance by states through toll-free telephone numbers and clarification as to the scope of the proposals. The only remaining issue would seem to be whether or not the nontaxpaying direct-mail industry should comply.

I recommend that this issue be resolved clearly and precisely through passage of the legislation being addressed by this hearing. Substantial tax avoidance and evasion, will continue as long as states are forced to pursue their taxes on a piecemeal basis in lengthy, case-by-case court proceedings and through ad hoc interstate agreements. The limitations of states' jurisdictions and the interstate activity intrinsic to this problem demand that an efficient and successful remedy begin with federal legislation. Only by legally specifying a compliance system as contained in S.1099 can the inherent problems of the issue be resolved and direct-mail advertisers be required to comply with the law.

November 30, 1987

Comments of The Newsletter Association
To the Subcommittee on Taxation and Debt Management
Committee on Finance, United States Senate
On S. 639 and S. 1099, to allow states to require
out-of-state businesses to collect state sales taxes

The Newsletter Association (NA) is the international trade group that represents more than 800 publishers of newsletters and specialized information services. Most members are for-profit, subscription-based firms.

NA members collectively publish more than 2,000 newsletters, most of which are specialized publications providing detailed, in-depth reporting on one specific subject, government agency or program. While NA includes some larger firms such as McGraw-Hill and The Bureau of National Affairs, the typical newsletter publishing venture is a very small operation.

NA will not address in detail the broad issue of constitutionality of this legislation as it relates to requiring out-of-state businesses to collect tax for sales to states where no business presence is maintained. National Bellas Hess v. Illinois, 386 U.S. 753 (1967) makes clear that requiring out-of-state businesses to collect such tax is unconstitutional.

We know of no arguments advanced to contravene the precedent and logic established by the Supreme Court in this decision. It is illogical and unfair to force any business to collect tax from customers in states where the firm has no sales presence and does not benefit from fire and police protection, roads, transportation service, etc.

Because of the great harm the proposed legislation will do to small businesses we represent, NA asks that:

** If the legislation is to be approved at all, it keep exemptions for companies whose mail-order business nationally is beneath $12,500,000 and less than $500,000 in an individual state. (We note that the concept of such a floor, in S. 1099, was endorsed by the Treasury Department, in testimony by Dennis Ross.)
** Those exemptions increase annually at the same rate as the CPI.
** Congress require that states provide computer programs to simplify collection of such taxes.

Exempting Small Business

The proposed legislation now exempts firms whose mail order business nationally is below $12,500,000 and less than $500,000 in an individual state. If these levels were substantially reduced or eliminated, this legislation would impose an excessive administrative burden on newsletter publishers.

Newsletter subscriptions are sold almost entirely via direct mail. The nature of direct mail selling being what it is, most newsletter publishers -- even comparatively small firms -- will have clients in nearly every state.

Many states now exempt serial subscriptions, including newsletters, from collection of sales tax, whether the subscriber is in or out of the state. It is neither realistic nor reasonable, however, to expect small businesses to keep track of changing exemptions for subscriptions in 46 jurisdictions.

Most newsletter firms also market books, reports, directories and other publications to subscribers and non-subscribers. Those items might be subject to sales tax in states that exempt newsletter subscriptions. Here again, it will be hard for a small firm to follow changing rules and rates in 46 states.

Direct Marketing Assn. studies show that about 9% of customers ordering merchandise on which sales taxes are due fail to remit them. As subscriptions usually have been understood by the public to be tax exempt, the percentage not complying with legislation (at least initially) can be presumed to be double or triple 9% -- creating another big burden and expense on the smaller publisher.

The vast majority of NA members have 15 or less employees; many have less than six employees. Companies with a small staff will suffer an undue burden in trying to figure what taxes apply to each sale, monitoring the customer's compliance, submitting taxes to the states, and keeping up with recordkeeping that will be necessary.

Indexing the Exemptions

The exemptions for companies whose mail-order business nationally is below $12,500,000 and less than $500,000 in an individual state are reasonable. But the memories of double-digit inflation make it vital that small businesses be protected against the exemptions' floors being eroded.

NA therefore urges that the legislation be amended to provide that the $12,500,000 and $500,000 floors increase annually at the same rate as the Consumer Price Index.

This appears much fairer and more efficient than making small companies return to Congress repeatedly to seek changes in outdated exemption levels.

Computer Capabilities

Many firms affected by the proposed revisions lack the computer capability needed to handle the increased paperwork and recordkeeping. A typical small newsletter company writes 27 checks per month. In months that tax checks must be sent to states, they could increase the number of checks written by 70%.

Another burden on small firms would be trying to deduce which customers are exempt from tax. Many NA members (especially those that provide business-to-business information) have major sales to government agencies, educational institutions and non-profit organizations that are exempt from sales tax.

Companies would have to determine, in each sale of a non-exempt product, where the customer was located, what the tax rate is and whether the customer is tax-exempt. The burden often could not be handled with current personnel.

IRS is making firms filing 250 or more W-2 forms to submit withholding data on magnetic tape [IRS Revenue Procedure No. 87-35, Publication No. 1220]. The logic of this works in the reverse — states should (in return for making out-of-state firms be collection agents) provide software, usuable on major computer brands, that eases the burdens of tax collecting.

Summary

It is essential to small business that, if the legislation is approved, it exempt firms whose mail-order sales are below $12,500,000 nationally and less than $500,000 in a single state.

To prevent inflation from eroding the exemptions, they should increase annually at the same rate as the CPI.

If states want businesses to act as their collection agents, the states should provide computer programs to simplify collection of such taxes.

We appreciate the opportunity to present the views of the newsletter publishers who are members of the Newsletter Association.

STATE OF NORTH CAROLINA
DEPARTMENT OF REVENUE
P O BOX 25000
RALEIGH, N C 27640

December 1, 1987

Ms. Laura Wilcox
Hearing Administrator
United States Senate Committee on Finance
Room SD-205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Ms. Wilcox:

I have been advised by the National Association of Tax Administrators (NATA) that the Senate Finance Subcommittee on Taxation and Debt Management has conducted hearings on S.639 and S.1099 which deal with interstate taxation and that the Subcommittee has urged interested persons to submit written statements in connection therewith for inclusion in the printed record.

It has been well established that the Bellas Hess decision rendered by the Court in 1967 permits an ever-increasing number of mail order and direct marketing vendors to exploit the consumer markets of the states without collecting and remitting tax on their sales. As a result of this immunity from taxation, it is our opinion that the states suffer substantial revenue losses, their local vendors are placed in a noncompetitive position with such mail order and direct marketing vendors insofar as collection of the sales and use tax is concerned, and the twofold purpose of the sales and use tax system to equalize the tax burden on all taxpayers is adversely affected. The thrust of the proposed Federal legislation is, of course, to eliminate this inequity by expanding the states' jurisdictional standards to permit the states to reach the mail order and direct marketing vendors and require collection of the tax so that such tax falls uniformly on local and interstate vendors. Such legislation will correct the use tax avoidance problem created by the Bellas Hess decision.

I agree with the objectives of S.639 and the principle in S.1099. I appreciate this opportunity to set forth my support for such Federal legislation which is so urgently needed and request that my expression of support be made a part of the printed record. The North Carolina Department of Revenue is in accord with the statement presented by the National Association of Tax Administrators and commends it to the Senate Finance Subcommittee on Taxation and Debt Management.

In accordance with the November 6, 1987 bulletin of the National Association of Tax Administrators, copies of this letter are being sent to Ms. Mary McAuliffe, Minority Chief of Staff, United States Senate, Committee on Finance.

Sincerely,

Helen A. Powers

Helen A. Powers,
Secretary

STATEMENT OF MICHAEL B. FISHER
PRESIDENT OF
PARCEL SHIPPERS ASSOCIATION
BEFORE THE
SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
NOVEMBER 6, 1987

My name is Michael B. Fisher, I am President of the Parcel Shippers Association, a group of approximately 200 businesses which utilize the U.S. Postal Service and other carriers to ship parcels in interstate commerce. Because shipment almost always is from our seller/member in one state to a customer in another state, S.639 and S.1099, were they to become law, would have a negative impact upon our members.

First, there is a public misperception that there is an inequity in the current situation which gives out-of-state sellers an advantage over in-state retailers because out-of-state sellers do not have to collect sales tax. As a practical, commercial matter, most mail order sellers, including the overwhelming majority of our members, charge a shipping and handling charge to cover the costs of shipment by mail. While this charge varies from case to case, it is a charge which the local retailer does not assess to a customer walking into the store. Thus, in the overwhelming majority of situations, while an out-of-state mail order buyer may not be paying sales tax, he is paying a compensating charge because he is buying by mail, which certainly causes that customer not to perceive any "advantage" by saving sales tax dollars.

Further, the argument has often been made that the largest mail order companies collect sales tax in every state, so other companies must be able to do this. While much can be said of this specious comparison, at least a few points must be understood clearly. The two largest mail order companies operate in every state and benefit from being present in each state. Besides benefitting from various state services, the local presence and name identification enhances those companies' mail order sales opportunities. They have regional distribution

centers and many of the so-called "mail order" sales are actually consummated at a store order counter. The point is that the computation of sales tax in such cases is no more difficult than it is for an in-store retailer.

Most of the members of the Parcel Shippers Association, on the other hand, have single locales from which they would have to compute the plethora of state sales tax rates, each based on different rules. While there are only 46 taxing jurisdictions under the formulation in the proposed legislation, varying rules and rates apply in each of those jurisdictions. Clothes are taxed or clothes are not taxed; food is taxed or food is not taxed; clothing under a certain value is not taxed; children's shoes are taxed or children's shoes are not taxed; food sold with non-food items is taxed on the value of the whole or food sold with non-food items is taxed only on the food components, etc. Merely being in the age of computerization does not give our members, which are businesses vastly smaller than the two giants of retailing, the wherewithal to deal on the so-called "level playing field".

Furthermore, when a sales tax is assessed in a store transaction or with a clerk, if the sales tax is not forthcoming the transaction is not consummated. In a mail order situation at my company, for example, tens of thousands of times each year customers "stiff" us for the sales tax portion of the bill, and, while we pursue the amount due to the same extent we would pursue a like amount due if unpaid on the product itself, it often is unfeasible to instigate persistent, effective collection efforts for $1.80 or $2.34 or $7.69. Yet, we still must remit these amounts to the state. The fact that a tax is due but not paid is already a costly element to those of our members who do collect sales tax where required to under the tests set forth in National Bellas Hess and related cases.

In fact, the National Bellas Hess case, besides mentioning Commerce Clause considerations, discusses at some length the due

process considerations of a state hundreds or even thousands of miles away ordering a company which has no contact with the state and derives no special benefits therefrom to become its collection agent. If a tax is really due from the customers, as is the case in a use tax situation, the state ought to deal with its customers and not interfere with a business which has no relationship whatsoever with it.

In fact, the tests set forth in Bellas Hess and related cases actually operate properly to cause many companies to collect sales tax. My own company, Fingerhut Corporation, for example, now collects sales tax in a number of states because the requisite nexus is present; we do not collect in others where there is no such nexus. To us the system does work. While we sympathize with the great need for revenue which all governments are experiencing, S.639 and S.1099 are not the appropriate solution to the problem. This is not a loophole.

I ask that the Subcommittee specifically reflect on the following. Just as this statement addresses our legitimate concerns, our industry has continually advised members of both houses of Congress, as well as governors and tax collectors, that the burdens on mail order sellers are real, and disproportionate to the burdens on retail sellers. For reasons which are not clear to our members, these disproportionate burdens are dismissed as not actually existing. They do! It is a fact that a full page or more must be printed with instructions to deal with the vast matrix of rates and coverages. This is not something a retailer must do, and it does raise our advertising (paper and printing) expenses. It also confuses customers in a way retail transactions, by their nature, do not. Also, a number of our customers do not pay us. Yet we must remit the tax.

I am told that sound political decisions address needs of opposing parties. It is for this reason I do not understand why neither the pending legislation nor its authors have tried to fashion legislation which might address the legitimate concerns of both sides of this question.

We must oppose the one-sided, punitive legislation being considered by the Subcommittee.

The Direct Marketing Association has testified before this Subcommittee that collection of sales tax is three to fifteen times as expensive for mail order companies as it is for store retailers. The members of our Association corroborate that. Further, revenue estimates by proponents are vastly overstated. We also urge greater understanding of the very real issues raised here by our member L. L. Bean.

In summary, this bill will not level any playing fields. The benefits of such legislation are greatly overestimated while the burdens of high collection costs are understated. The bill offends notions of due process. A line of cases since National Bellas Hess have shown that a company with appropriate nexus can be made to collect use tax.

For those reasons we respectfully urge that S.639 and S.1009, or any bill with a like purpose and like disregard for the legitimate concerns of our industry, not be enacted into law. Thank you.

Reader's Digest

RICHARD F. McLOUGHLIN
President
Chief Operating Officer

November 7, 1987

The Honorable Max Baucus
United States Senate
706 Hart Building
Washington, D.C. 20510

Dear Senator Baucus:

I am President of The Reader's Digest Association, Inc. located in Westchester County, New York. I understand that there is a possibility that bills which would require us to collect use taxes in states where we have no presence, may be heard in November or December.

I urge you to oppose this idea. The arguments against these proposals are well summarized in the enclosed backgrounder from the Direct Marketing Association and The Wall Street Journal editorial of October 6, 1987. I write to you, also, to point out that the burdens of this legislation would affect our sales, our profits, and our ability to contribute to the economy of New York State, as well as diminishing the amount of income tax we would be contributing to fund the Federal Budget in the future.

I hope that if any of these proposals should come to a vote that you will oppose them.. I would very much appreciate hearing from you regarding your views on this matter.

Thank you.

Sincerely,

Richard F. McLoughlin

dma

DIRECT MARKETING ASSOCIATION, INC.

Backgrounder: Federal Use Tax Legislation

Under the U.S. Constitution a state may not require an out-of-state seller to serve as the state's tax collector unless the seller has some connection with the taxing state and receives some benefit from the state's services and protections. A sufficient link with the taxing state (called "nexus") was deemed necessary by the U.S. Supreme Court to satisfy the requirements of Due Process and to prevent an undue burden on interstate commerce.

HR 1242 and other similar bills would attempt to overturn this line of Supreme Court rulings and give every state the authority to require out-of-state marketers to collect and remit state use taxes. This legislation would change the ground rules for a large segment of American business and impose significant unproductive costs on national marketers. Here are some of the problems we see with HR 1242:

1. **HR 1242 is unconstitutional.** Although Congress may set national standards for what constitutes nexus (consistent with due process), federal legislation to do away with the nexus requirement altogether (or emasculate it) would almost certainly be declared unconstitutional. HR 1242 is an attempt to give states the authority to impose tax collecting duties on businesses that have no presence in the taxing states, receive no direct benefits from the services of those states, and have no political voice to affect those tax laws.

   Commerce Clause concerns are equally important. In this area the Court has deferred to congressional judgment. There are substantial policy reasons embedded in the Constitution why states should not have the authority to burden the national economy with their individual tax laws. Since Congress is the final authority in this area, it is particularly important that no precipitous action be taken that would adversely affect the national marketplace.

2. **HR 1242 would impose large unproductive compliance costs on national marketers.** It is much more costly and inefficient to collect taxes through the mail than it is in person at a cash register. Studies indicate that the costs are six times as great. HR 1242 would require thousands of direct marketing companies to cope with 46 different rates and 46 sets of exemptions and file a minimum of 184 forms annually. Companies with product lines presenting tax complexities (clothing, food, gifts, etc) or with customers who pay primarily by check would have enormous problems.

3. **HR 1242 would cost jobs and hurt the U.S. economy.** Direct marketing is a labor-intensive industry which also provides business to printers, mailers, ad agencies, common carriers, and suppliers. HR 1242 would reduce profits and spending by direct marketers, and thus would have a significant negative impact on employment in all facets of the direct marketing industry.

4. **HR 1242 would reduce federal tax revenue.** The costs of collecting these various state taxes would, of course, reduce the taxable income of every affected business. Without attempting to measure indirect costs to the economy and employment, the direct result of HR 1242 could be a reduction in federal tax receipts of over $100 million a year.

5. **HR 1242 is a chance for Congress to vote for a raise in state taxes.** If HR 1242 were to pass, mail order customers would be paying more taxes to their states (and enduring the aggravations described below) as a result of federal legislation.

6. **HR 1242 would not raise significant amounts of state revenue.** The purpose of HR 1242 is to allow states to collect more revenue without having to raise taxes. In fact, however, most states would net very little additional revenue from this legislation and some states could actually lose revenue.

7. **HR 1242 is unfair.** Congressman Dorgan claims that direct marketers have an unfair competitive advantage over retailers because they are not required to collect sales tax. This statement assumes that mail order customers are significantly influenced by the presence or absence of a sales tax; and this assumption is false. The average direct marketing purchase is for just over $50. The cost of postage and handling is more than the tax in most cases, and the typical mail order shopper is not focusing on price in any case. In an effort to make sure that all sellers charge the same tax, HR 1242 would impose collection costs on national marketers that are six times greater than those incurred by the average retailer.

8. **HR 1242 would produce a major aggravation for American consumers.** Collecting the use tax is not only inefficient for governments and businesses, but aggravating for consumers. The Customer Hassle Chart (attached) shows some of the problems customers would encounter.

THE WALL STREET JOURNAL TUESDAY, OCTOBER 6, 1987

REVIEW & OUTLOOK

Mail-Order Grinch

With fewer than 70 shopping days till Christmas, millions of Americans are avoiding long lines, bad weather and crowded parking lots by doing some or all of their Christmas shopping by mail. Many people find mail order more convenient and sometimes cheaper, since state sales taxes aren't charged if the recipient is out-of-state. But if Rep. Byron Dorgan (D., N.D.) has his way, mail-order firms will have to collect sales taxes on all their transactions. The House Ways and Means Committee will vote on his bill next month. If it passes it will be just in time to give consumers an unwelcome holiday present.

Mail-order and direct-marketing sales are booming. Interstate sales top $100 billion a year and represent as much as 14% of all retail business.

Rep. Dorgan's bill would cost mail-order consumers up to $1.5 billion. Several business groups support the measure; they argue that the companies that send tax-free merchandise through the mails are unfair competition for local retailers. Mail-order firms respond that the Dorgan bill would impose enormous compliance costs.

L.L. Bean, a catalog store in Freeport, Maine, claims that just printing the different tax rates and exemptions in its catalog would cost $10 million a year. Studies indicate it costs direct marketers three to 10 times as much money to collect sales taxes as it does for retail companies. The 45 states and 7,000 localities with sales taxes have never agreed on a coordinated plan of collection, so the only way to enforce payment of mail-order taxes is to allow dozens of different auditors to inspect catalog companies' books.

In 1967, the Supreme Court ruled that states would violate the Constitution's commerce clause if they levied a sales tax on out-of-state retailers that had no presence in the state beyond advertising. Since the Constitution gives Congress the power to regulate interstate commerce, Rep. Dorgan wants Congress to define what a minimum business presence in a state is in a way that allows out-of-state sellers to be taxed.

But even if that argument is upheld by the Supreme Court, taxing mail-order firms may also violate the due-process clause of the 14th Amendment because the firms being taxed won't benefit from state government activities. The Treasury Department is concerned about the bill because it would require the Internal Revenue Service to share sales-tax data filed by merchants with state tax collectors, thus inviting public suspicion about the confidentiality of federal tax returns.

Retail merchants that back the Dorgan bill, such as J.C. Penney, are correct in saying that mail-order companies are at a competitive advantage in not having to charge sales taxes, which can range as high as 9%. But that isn't an argument for creating an enforcement nightmare that could drive some mail-order merchants out of business. It is an argument for states to consider reducing any sales taxes that are so high that they induce people to shop out-of-state for goods.

In Dr. Seuss's tale, "How the Grinch Stole Christmas," a dour figure swept down on Whoville and made off with all of the Christmas presents in the town. But, in the true spirit of the season, the inhabitants celebrated anyway. Christmas would also still be the same if Rep. Dorgan's bill passes, but that is no reason to make consumer goods more expensive for people by chasing their dollars across state lines and slapping a constitutionally dubious tax on them.

STATEMENT OF GRADY L. BOOKER
ON BEHALF OF THE
SOUTHWEST HOMEFURNISHINGS ASSOCIATION

December 4, 1987

Mr. Chairman, distinguished members of the Subcommittee, I appreciate the opportunity to submit this testimony to you on behalf of the members of the Southwest Homefurnishings Association. I would like to briefly address the issue of sales tax collection on interstate sales by out-of-state vendors, as well as express our support for S. 639, sponsored by Senator Quentin Burdick, and S. 1099, sponsored by Senator Thad Cochran.

Southwest Homefurnishings Association, a retail trade association serving retail furniture and home furnishings store owners as well as manufacturers and wholesalers, has members in 43 states with the heaviest concentration being in Texas and the American Southwest. While we have many members who do business in large metropolitan areas, the majority of our retail members are located in relatively small towns.

In that furniture stores have traditionally occupied leadership roles in their communities, constituting the social and economic fabric typical of its people, our members truly represent the hopes and desires, the trials and tribulations, of Main Street U.S.A.

As for the issue at hand, I do not want to dwell on its detailed history; however, I do want to point out that since the 1967 United States Supreme Court decision, National Bellas Hess v. Illinois Department of Revenue, out-of-state direct marketers (who utilize such methods as mail-order, toll-free telephone numbers and computer shopping) and border sellers (who set up operations just across state borders) are not obligated to collect sales and use taxes from buyers and remit the revenue to the home state (and/or city) of the purchaser.

In the twenty years since this court decision was handed down, the untaxed out-of-state firms have proliferated. On a nationwide basis, direct marketers account for 14 percent of all retail sales, which translates into $150 billion per year. According to the Direct Marketing Association, direct marketers will control 20 percent of U.S. retail sales by 1990.

In Texas, the state in which the greatest number of our members reside, there will be approximately $7.3 billion of mail-order sales this year alone. As a result of these sales, the State of Texas will lose approximately $159 million

For home furnishings retailers, the problem is even more critical regardless of where they live. It is not uncommon for a furniture retailer to spend hours helping a customer select the style and colors of furniture he or she wants to buy, only to have the customer leave the store and dial a toll-free number to an out-of-state mail-order firm to place the order. Sometimes, the customer adds insult to fiscal injury by using a pay phone directly in front of the store.

Many retailers in the South and Southwest are on the brink of bankruptcy after the downturn in their state economies. The unfair competition presented by untaxed direct marketers is threatening to push many over the edge.

Home furnishings retailers are not afraid of competition but they deeply resent -- as do all retailers -- unfair competition that puts them at a possible 8% disadvantage (depending upon the local sales tax rate) not including their own cost of overhead. The loss of just one sale to out-of-state vendors can represent a huge percentage of business to a retailer who may only do $500,000 in annual sales.

This typifies the great disparity of competition that currently exists. Small, independent business owners are forced to compete with huge multi-million dollar direct marketing corporations -- who already have an approximate 8 percent price advantage.

Home furnishings retailers welcome competition regardless of its source. All we ask for is fairness and the even application of a tax system that already exists. We are not asking for the creation of a new tax -- just a chance to compete on a level playing field so that we may continue to serve our communities.

With this in mind, the members of Southwest Homefurnishings Association urge each of you to support both S. 639 and S. 1099. We thank you for your time and sincerely appreciate your consideration of this very important issue.

Taylor Gifts

355 E. CONESTOGA ROAD
POST OFFICE BOX 206
WAYNE, PENNSYLVANIA 19087
PHONE (215) 688-3046
FAX (215) 293-3690

Gifts of Distinction
BY MAIL

October 29, 1987

Ms. Laura Wilcox
c/o Senate Finance Committee
Dirksen Office Building
Washington, DC 20510

RE: HR 1242, HR 1891
Mailorder State Use Tax

Dear Ms. Wilcox:

As president of Taylor Gifts, Inc., I wish to express my deep concern regarding proposed federal legislation to require mail order companies to collect state use tax for all states using our catalog as a shopping vehicle.

Such a requirement would be expensive, confusing and most of all, inefficient. It appears that very little consideration has been expended toward the burden placed on mail order companies should they be forced to execute this collection of taxes by mail. As residents of the state of Pennsylvania, we accept the duty of tax collection and benefit from our state's services and protection. I consider this proposed requirement a gross injustice and a burden on our business.

The Direct Marketing Association has enlisted the services of an economic consulting firm to study tax collection costs for direct mail companies. The results of this study indicate that they average over 15% of taxes collected or 7 times greater than retail store costs. Our cost would be approximately $135,000. Collecting taxes in all 50 states would create additional expense.

Millions of Americans take advantage of the opportunity provided by direct marketing - a positive boost to the economy. How such a proposal would be in the national interest is beyond me. Our employees number 125 and our company pays state and federal taxes in excess of $178,000. Our sales, profit and ability to make a positive contribution to the economy would definitely be adversly affected by this legislation.

I realize that this proposed legislation is coming before the Senate Finance Committee. Please convey our strong opposition to this proposal to the committee.

Very truly yours,

B. LOYALL TAYLOR, JR.
PRESIDENT

November 5, 1987

Laura Wilcox
Senate Finance Committee
Room 205
Senate Dirksen Office Building
Washington, D.C. 20515

Dear Ms. Wilcox:

We at the Lillian Vernon Corporation wish to submit the following testimony to the Hearing regarding bills S.639 and S.1099 before the Senate Finance Committee.

The Lillian Vernon Corporation is a publicly held corporation whose main line of business is selling merchandise from catalogs it mails throughout the United States. Currently our sole location is in New York State and, in 1988, we plan to open a Distribution Center in Virginia. We collect sales tax on all shipments to New York State and plan to collect tax on shipments to Virginia beginning in 1988.

Collecting and remitting tax from sales in these states is something we believe is appropriate and just. Both New York and Virginia provide us a forum for determining the tax rate, e.g. the right of our employees to vote for lawmakers in these states. New York and Virginia also provide us significant services, such as police, fire protection, employee recruiting and training. In short, the taxes we pay, or will pay, these states go to services which benefit us.

The current bills suggest that we collect and remit tax to states in which we have no presence, in which we receive no benefit from these taxes and in which we do not have the ability to vote. Simply this would be taxation without representation, flying in the face of one of our country's founding principles.

But the problem runs deeper. An impetus for the proposed law seems to come from retailers' complaints that they are losing business to mail order companies because <u>shoppers save the sales tax.</u> Therefore, the reasoning goes, if mail order firms charge sales tax, it will create an "even playing field."

We think this reasoning is specious. First, most direct mailers charge a shipping and handling charge roughly double the rate of sales tax. Shoppers gain no advantage here. Second, retailers collect tax before a shopper leaves the store. The direct mailer's quandry is that from 5 to 10% of shoppers will under-remit tax when they mail in their order. Unlike the retailer, the mailer is faced with Hobson's choice: ship the goods and make up the difference, keeping a good customer; or contact the customer for the extra few dollars and hope to keep the communication cost low and to keep the sale. Either way the direct mailer's cost involved with collecting tax would be <u>higher</u> than the retailer's cost. There is no "even playing field" here.

In summary, we at the Lillian Vernon Corporation, think S.639 and S.1099 make bad law. States would be taxing mail order companies inequitably compared to in-state retailers. States would be taxing mail order companies who have neither a voice in the taxing decision nor a benefit from the tax dollars paid.

Sincerely,

James S. Forbush

James S. Forbush
Vice President

November 24, 1987

Senator Max Baucus, Chairman
Senate Finance Subcommittee on Taxation and Debt Management
United States Senate
205 Dirksen Building
Washington, D.C. 20510

Dear Senator Baucus,

As president of Vertex Systems Inc., I have followed with interest the subcommittee's testimony related to the proposed taxation of mail order sales (bills S.639 and S. 1099).

Vertex Systems is in the business of providing tax services to companies throughout the United States. One of our principle products is a service that provides sales tax rate information and associated software.

I am submitting this statement for inclusion in the printed record of the hearing to clarify some of the misconceptions about our services that were presented in previous testimony as well as to present a possible approach for resolving some of the conflict between opponents and proponents of the bills.

Vertex advocates no position regarding the passage of either S. 639 or S. 1099. Our testimony is intended solely to provide the subcommittee with facts so that whatever decisions are reached can be done so based on the best available information.

Background

Vertex Systems has been in the business of providing tax related products to U.S. businesses during the past thirteen years. As mentioned above, one of the principle products offered is a computerized service called SALESTAX™that provides sales and use tax rate information for every taxing jurisdiction in the United States. The service includes all the sales and use tax rates currently imposed by the approximately 7,000 taxing jurisdictions levying such taxes today. All state, county, city and transit district tax rates are included.

In order to obtain this information, Vertex has established communication channels with each of the taxing jurisdictions to obtain the rate changes on a timely basis. Timing is critical since companies must have updated tax rates prior to the first of each month to insure that accurately prepared bills are produced.

The Vertex tax rate service is offered both on magnetic tape and in hard copy format. The tape service is generally used by our customers to interface with their billing systems. Once an account is ready for billing, a customer's billing system will typically access the Vertex tax rate file to extract the appropriate tax rate which is then used to calculate the tax amounts that are reflected on the customers bill. Other customers use our tax rates in "on-line" systems so that customer service representatives can quote total charges (product amounts plus applicable taxes) to customers over the phone.

The tax rate information can be accessed by one of several methods depending on an individual customer's needs. For example, the tax rates can be obtained by using only ZIP codes, using a combination of ZIP codes and city names, using the Federal Information Processing Standard(FIPS) Code which is maintained by the National Bureau of Standards, or by using a "GEO" code which is maintained by Vertex. The FIPS and GEO codes are different pre-defined code sets that represent essentially every county, city or town in the United States with a population exceeding 250 people. A total of approximately 50,000 GEO codes and FIPS codes are each currently included on the SALESTAX file.

The SALESTAX file contains both current and previous tax rate information and the effective dates of each. This information allows customers to access the proper rate regardless of when rates change or when their bills are produced. It also allows the retrieval of the correct rate when processing credits or adjustment bills that may pertain to data that is several months old.

In addition to the tax rate information, the SALESTAX System also includes software that can be used to do the actual tax calculations. The software contains the logic necessary to accomodate all the different taxing idiosyncrasies currently used by any taxing jurisdiction. Hundreds of companies are using this software to accurately compute their taxes today. The software also produces reports that provide the data necessary to prepare the sales and use tax returns that have to be submitted to each of the taxing jurisdictions.

The software is extremely flexible. It can operate effectively on essentially any hardware. It also readily allows individual customers to enter special conditions related to a particular situation or unique industry practice.

The SALESTAX Service sells for $6,400 for the initial year and $3,650 for subsequent years' renewals. The hard copy tax rate service sells for $530 annually.

Observations

The success of Vertex has been attributable in large part to the ability to provide a service that is not only accurate and timely but one which can meet the needs of a broad spectrum of American industry. I believe that this service could provide the mail order industry with the resources that they need to meet whatever tax obligations ultimately result from the proposed legislation. Indeed, our service is currently used by a number of nationally known mail order companies today.

I would also like to comment on one problem that is unique to the mail order industry and to offer a potential solution. The issue involves the fact that most mail order customers are not billed in the traditional sense. Instead, the customer typically orders merchandise from a catalogue and sends both the order form and payment to the vendor. Thus, mail order firms cannot effectively control the amount of tax, if any, that has been computed and submitted by the customer without a rather costly effort. I think that the mail order industry has effectively communicated their concern on this issue--a concern that appears valid based on my experience.

Perhaps a compromise position that one could consider on this issue would be to allow mail order companies to submit a listing and/or magnetic tape to the appropriate states of names and addresses of customers that did not remit correct state and local taxes with their order. In exchange for providing this information, the states' would agree that the mail order firms would not bear any liability for the tax on these transactions. Such an agreement, coupled with a somewhat higher tax collection credit for mail order activity, might be viewed by both the states and the mail order industry as an acceptable alternative to their positions taken on this legislation to date. It would reduce the costs to the mail order companies and provide the states with information that they could use to consolidate and collect the tax through their considerable enforcement powers.

I appreciate the opportunity to provide this statement and am available to answer any questions that the subcommittee might have.

Ray Westphal
President

RW:bp

TOMMY G. THOMPSON

Governor
State of Wisconsin

November 19, 1987

FEDERAL EXPRESS MAIL

Laura Wilcox
Subcommittee on Taxation and Debt Management of
the Senate Finance Committee of the U.S. Congress
Room 205 - Dirksen Senate Office Building
Washington, D.C. 20510-6200

Dear Ms. Wilcox:

I, as Governor of the State of Wisconsin, oppose enactment of S. 639 and S. 1099. These bills would eliminate the nexus restriction and give states the authority to require mail-order companies to collect and remit state use taxes in every state where they have customers. Following are reasons why this use tax on mail-order companies should not be enacted into law:

1. The mail-order industry is a very significant industry in the State of Wisconsin and is also very beneficial to the farm economy. Wisconsin mail-order companies sell many types of merchandise, including food and clothing. Those selling food products annually sell $250 to $300 million of food produced in Wisconsin to customers in other states. This proposed legislation would not only be detrimental to these mail-order companies, but Wisconsin's farm economy would also be affected.

2. The cost of collecting the use tax by mail-order companies would be substantially higher than the collection of costs to retailers who have the ability to collect the tax at the cash register because of the complexities caused by different exemptions, tax rates, etc., applicable to the different states.

3. The numerous different exemptions in the states would make it very difficult to properly know if the tax should be charged and, if so, what part of the sales price would be subject to tax. For example, children's clothing is exempt from tax in several states. What sizes constitute children's clothing and what sizes are clothing for adults? Some states exempt only certain types of food. Gift boxes may be party food, partly wrapping, partly non-food items, etc. What part of the sales price would be taxable?

4. The potential tax revenue from these two bills would be less than the amount indicated by some state tax administrators.

5. Sales by mail-order companies would likely be reduced and their costs would be increased, thereby reducing their profitability, their taxable income, and their ability to expand and create new jobs. In many cases, the mail order companies would discontinue operations rather than comply with S. 639 and S. 1099.

6. Mail-order companies without nexus in a state would be required to incur substantial expense to collect the tax without any benefit or use of that state's services.

I recognize that states are currently losing some tax revenues from mail-order sales to customers in their states because their residents are not voluntarily complying with their use tax law. However, S. 639 and S. 1099 are not the solution to this complex problem. Although the proposed legislation would bring in additional state tax revenues, the offsetting reduced profits, loss of jobs, etc. will have negative consequences to the State of Wisconsin. The farm community, the heart of Wisconsin's economy and the principal supplier of raw materials for sales products of many Wisconsin mail-order companies, would be adversely affected.

Wisconsin industry welcomes federal legislation which will help it expand, become more profitable and create jobs. The proposed legislation in S. 639 and S. 1099 does not accomplish this.

Sincerely,

Tommy G. Thompson

TOMMY G. THOMPSON
Governor